[redacted]

ANNE SAUSER, Administratrix
OF PHILIP SAUSER, DECEASED,

[redacted]

MID-CONTINENT PETROLEUM CORPORATION, Respondent.

[redacted]

BRIEF ON BEHALF OF [redacted]

[redacted]

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IN THE SUPREME COURT OF THE UNITED STATES.

October Term, 1933.

No. 660

ANNIE SAUDER, ADMINISTRATRIX OF THE ESTATE OF PHILIP SAUDER, DECEASED, *ET AL., Petitioners,*

vs.

MID-CONTINENT PETROLEUM CORPORATION, A CORPORATION, *Respondent.*

BRIEF *on* BEHALF *of* RESPONDENT.

May It Please the Court:

This action was commenced in the District Court of Greenwood County, Kansas, by Philip Sauder against the respondent, seeking the cancellation of the undeveloped portion of an oil and gas mining lease covering 360 acres of land in said Greenwood County. Subsequent to the removal of said case to the federal court Philip Sauder died and the action was revived in the name of the petitioners herein, who are his sole and only heirs at law. The aforesaid lease was executed and delivered to respondent's predecessors in title on June 6, 1916, and contains the following provisions:

"That the said parties of the first part in consideration of the sum of $1.00 (One) Dollar, receipt of which is hereby acknowledged to them duly paid by the said parties of the second part, and of the covenants and agreements hereinafter contained on the part of the said parties of the second part, to be kept and performed, do hereby lease and let unto the said parties of the second part the exclusive right for ten years from date hereof, *and as long thereafter as oil or gas can be procured thereon in paying quantities,* to enter upon, operate for and procure oil and gas upon the following described premises, situated in Greenwood County, State of Kansas, to-wit, East 1/2 of Section 16, Town. 23, Range 13, acres 320. Southeast 1/4 of Southwest 1/4, Sec. 16, Town. 23, Range 13, acres 40.

* * * * * * *

"If oil or gas be found *on these premises* by said second parties, *all rights, benefits and obligations secured hereby* shall continue so long as either can be procured in paying quantities.

* * * * * * *

"In case no well be commenced on said premises within one year from date hereof, all rights and obligations secured under this contract shall cease upon notice in writing from the said first parties. *Provided, however,* that the said second parties shall have the right to continue this lease in force from year to year, until a well is drilled thereon, by paying at any time within ten days from date of the service of said notice, an annual rental of $1.00 per acre for said premises. Said rental to be deposited to the credit of said first parties in Citizens State Bank in Gridley, Kansas, payable quarterly in advance." (R. 6-7)

The petitioners concede that during the primary term of the aforesaid lease, or in other words, during the first ten years after its execution, the respondent or its predecessors in title completed two wells upon the southwest 40

acres of said lease, that oil was discovered in paying quantities in each of said wells, and that at all times since the completion of said wells they have produced oil in paying quantities and are still so producing. The first of said wells was completed on or about the 1st day of November, 1921, and the second on or about the 1st day of January, 1922. Other than the aforesaid wells there has been no development upon the leased premises (R. 16, 30).

Primary Question Involved Herein.

The primary question herein is whether, under the evidence and the lease sought to be cancelled, there was any implied obligation upon the part of respondent to drill an additional well or wells upon the leased premises.

Importance of Question Involved Herein.

Two facts, *first,* the universal rule that an oil and gas lessee is not unconditionally required to drill an exploratory well at every location upon the leased premises, but is only required to drill such wells as an ordinary prudent operator, under all the circumstances, would drill, and, *second,* that due to the reliance of such lessees upon such universal rule it has been unusual to drill an exploratory well at every location upon even a producing lease, combine to render the decision of this court in the case at bar of unusual importance to the oil and gas industry.

In this day of enforced conservation of oil and gas, two of our great natural resources, the adoption by this court of the rule contended for by the petitioners would be deplorable, since such a rule would require the drilling of an unprecedented number of wells, which, if successful, would

result in augmenting the already over-production of oil and gas, and, if unsuccessful, would result in a foolish waste of money.

Petitioners' Amended Petition.

The only allegations contained in the petitioners' amended petition which in anywise allege a breach of the respondent's implied obligation to further develop the premises covered by its oil and gas lease are as follows:

> "* * * That from the oil wells upon adjacent land, although none are closer than four hundred feet from plaintiffs' line, several are close enough, that plaintiffs are informed and verily believe, and therefore allege, *that there is grave danger that oil deposits, if any, under the land of these plaintiffs, will be drawn off or depleted by the pumping of oil upon adjacent land;* that said oil production upon adjacent land has been going on for a number of years and that no new wells have been drilled upon said adjacent land since the year 1922.
>
> "Plaintiffs further allege and show the court that under the terms of said leases it was the duty of the holders thereof and especially of the defendant, Mid-Continent Petroleum Corporation, to fully explore and develop said lands for oil and gas, and plaintiffs allege that during the past years and ever since June 6, 1916, the said defendant, Mid-Continent Petroleum Corporation, and all of the parties to whom said lease may have been assigned, have wholly failed, refused and neglected to develop said land for oil and gas with the single exception of the two wells hereinbefore mentioned on the Southeast Quarter of the Southwest Quarter of said Section 16 and adjacent to the southwest corner of said half section herein described belonging to plaintiffs; that no effort whatever has been made to explore the east half of said Section 16; that the said

defendant, Mid-Continent Petroleum Corporation, although repeatedly requested and demanded so to do, as hereinbefore stated, has wholly refused, and failed to further develop said land for gas and oil.

"Plaintiffs further allege that since the year 1922, at least, the development of oil upon land adjacent to the land described herein belonging to plaintiffs has made it *practically certain that oil could have been discovered in paying quantities by the drilling of wells upon said East Half of said Section 16,* but that notwithstanding said fact, the said defendant, Mid-Continent Petroleum Corporation, has refused to develop said land and has held the same for speculative purposes and that by reason of such refusal said defendant, Mid-Continent Petroleum Corporation, in equity and good conscience, has forfeited its right to further hold said lease and should be by this court adjudged and decreed to be wholly in default of its obligations under the terms of said lease, and that said lease should be by the court cancelled, set aside and held for naught as to all of said land described herein, with the possible exception of land immediately adjacent to the two wells heretofore described lying and situate in the south part of the Southeast Quarter of the Southwest Quarter of said Section 16." (R. 19-20)

The prayer of said amended petition is as follows:

"*Wherefore,* the premises considered, plaintiffs pray for a judgment and decree of this honorable court, cancelling said lease and that said lease be cancelled, set aside and held for naught as to all of said lands, except such portion of said Southeast Quarter of the Southwest Quarter of Section 16, immediately adjacent to said two wells described in the petition herein, as the court may designate and plaintiffs pray that they have such other, further and additional relief as they may be entitled to receive in equity and good conscience, including their costs herein expended." (R. 20)

Petitioners' counsel, in drafting the foregoing petition, obviously understood that in order to justify the cancellation of the lease involved the evidence would have to establish two things, or at least one of them, to-wit: *(1)* That oil was being drained from under the lands involved by wells on adjacent premises; and, *(2)* that it was "practically certain" that oil could be "discovered in paying quantities by the drilling" of additional wells upon the premises involved. However, the petitioners wholly failed to prove either of these things, and the respondent overwhelmingly proved the very opposite.

Respondent's Answer.

The respondent in its answer admitted the drilling of the two aforesaid wells; that oil in paying quantities was discovered in each of said wells; that said wells had at all times produced, and were still producing, oil in paying quantities; and that it had not drilled any other well or wells on the leased premises. It further admitted that there were producing oil wells in the immediate vicinity of the lands covered by its lease, but denied that any of said wells was within 400 feet of the boundary line of said land, except certain wells offsetting the two wells on its lease. It denied that any of the wells in the vicinity of petitioners' lands were draining, had ever drained or were likely to drain any of the oil or gas from beneath said lands, and alleged that it and its predecessors in title had complied with all of the express and implied terms, covenants and provisions of its lease and that said lease was a good, valid and subsisting lease on the lands involved herein, and each and every part thereof. Respondent further alleged that it had

properly offset the wells upon the premises adjoining the lands involved herein, which it was required to offset under either the express or implied terms of its lease, and that it had drilled as many wells on the leased premises as under the circumstances would be reasonably expected of operators of ordinary prudence (R. 20-24).

Petitioners' Evidence.

The petitioners introduced no evidence whatsoever that if the respondent had drilled any additional well or wells upon the lands involved herein it would probably have discovered oil or gas in paying quantities, that is, in sufficient quantities to have repaid the cost of drilling, equipping and operating such well or wells, together with a reasonable profit on the entire outlay, or that a reasonably prudent oil operator would have drilled any additional well or wells, or that any of the wells on adjoining property had drained, was draining or was likely to drain any oil or gas from under the lands involved herein.

In his opening statement to the court counsel for petitioners made the following statement: "*However, the evidence also shows that in this field there are spots where there is oil and also spots where there is no oil and it is a field where it is impossible to tell whether a development of this lease would have yielded profits or would not and it is one of those cases where it is impossible to establish by geology because it is too speculative and the only resort we have is to cancel the lease.*" (R. 45)

The petitioners introduced in evidence their Exhibit No. 1, which was a map prepared by the respondent, and

which showed the location of the wells upon the lands involved herein, and upon the premises adjacent thereto, the date of the completion of each of said wells, the depth to which each well was drilled, and the initial production, if any, from each of said wells (R. 66A). Said map did not show, nor did the petitioners introduce any evidence to show whether or not said wells on adjoining premises produced oil or gas in paying quantities—or the amount of production required to constitute oil in paying quantities.

It was stipulated by and between the parties that the total of the one-eighth royalty paid by the respondent under the lease involved herein from 1927 to the date of trial was $760.50 for the year 1927, $658.45 for the year 1928, $623.90 for the year 1929, $495.45 for the year 1930, $239.23 for the year 1931, and for the year 1932 up to the date of trial an average of $21 or $22 per month (R. 46).

It was stipulated that respondent's Exhibits A, B and C, appearing at pages 67, 68 and 69 of the record, might be considered in evidence, and that they were substantially correct statements of the amount of oil and water which was then being produced from each of the wells upon the lands involved herein and the lands adjacent thereto; that said figures represented the daily average for approximately fifteen days prior to the date of said statements, and that there was a well being drilled at the time of the trial of the case at bar one-half mile north and 700 feet east of the east line of the petitioners' lands and that said well was down at the time about 1100 feet (R. 46-47).

In the course of the introduction of petitioners' evidence their counsel stated to the court: "The evidence will show, if you want it, that all this field in Greenwood Coun-

ty, that the production after three or four years goes down very rapidly." (R. 46)

The above and foregoing is all of the evidence introduced by the petitioners on the trial of the case at bar.

Respondent's Evidence.

Although the petitioners' evidence was undoubtedly wholly insufficient to entitle them to any relief whatsoever, the respondent produced four witnesses, each of whom qualified as an expert oil man with many years' experience in the development and operation of lands for oil and gas, and who were familiar, not only with the premises involved herein, but also with the lands in the vicinity thereof, and each of said witnesses testified that in his opinion it would not have been profitable for the respondent to have drilled any additional well or wells upon the premises involved herein and gave in detail his reasons for such opinion.

GEORGE O. MOODY, vice-president in charge of production of oil and gas for the respondent, testified that he had been engaged in the oil and gas business for about thirty-two (32) years, and that he had been engaged in such business in Kansas and Oklahoma continuously since 1916; that he was familiar with the lease involved herein; that the total revenue from oil produced from said lease from the time the wells thereon were drilled to December 31, 1931, was $72,694.18; that the royalty paid to the lessors in said lease was between $9,000 and $10,000; that the total expenditures in connection with the development and operation of said lease was $46,464.97; that said lease had shown a profit to the respondent of only approximately 5.1% per annum, which was a very small return for an oil

venture considering the large expenditures required and the great hazards involved; that respondent owned several leases covering lands adjacent to petitioners' land, but inasmuch as it had purchased all of said leases after they had been producing for some considerable time, except its Viola M. Griblin-A lease, it did not have the figures to show the revenue and expenditures in connection therewith; that its Viola M. Griblin-A lease had shown a profit to respondent of only approximately 6.8% per annum; that the wells located along the east line of the lease involved herein, shown on petitioners' Exhibit No. 1, were producing from two geological stratas, one called the Bartlesville sand and the other the Mississippi lime, and that the major portion of said wells were producing from the Bartlesville sand; that none of the wells to the east of the leases involved herein was drilled any closer than 660 feet to the east line of the premises involved herein because as they went west with the locations the oil decreased in volume and the water increased, showing that they were reaching the edge of the pool; that the development to the east demonstrated that the Bartlesville sand played out before it reached the east line of the lease involved; that in his opinion by going west one location from any of the wells east of said lease one would get a dry hole; that Shaffer & Howell owned the lease covering the Northwest Quarter (NW4) of Section 15, Township 23, Range 13, immediately east of the premises involved herein, and that the respondent herein had no interest whatever in said lease; that the closest well on said lease to the east line of the lease involved herein was well No. 4, which was 660 feet from said line, and that there was sufficient distance between that well and the east line of

the lease involved to have drilled an additional well; that the same thing was also true of all the wells located along the west side of the Shaffer & Howell lease, and that all of the other wells along the west side of the Shaffer & Howell lease were a greater distance from the east line of the lease involved than said well No. 4; that well No. 2 on the Theta Oil Company lease covering the Southeast Quarter (SE4) of Section 9, which lease adjoins the premises involved herein on the north, shown on petitioners' Exhibit No. 1, was a dry hole; that said well was drilled below where the Bartlesville sand was ordinarily encountered in this locality and was drilled below where oil in the Mississippi lime was ordinarily encountered in this locality; that no production was obtained in said well in either the Bartlesville sand or the Mississippi lime; that the well on the Northeast Quarter (NE4) of Section 21 south of the Theta well No. 2, being well No. 1 on the Viola M. Griblin-B lease, which said lease adjoined the premises involved herein on the south, was drilled through the Bartlesville sand to the Mississippi lime, and that the Bartlesville sand encountered was very broken and in a small amount, that no production was obtained in said sand, and only a very small amount of production was obtained in the Mississippi lime; that said well had not produced oil in sufficient quantities to pay the cost and expense of drilling and equipping it, and probably never would pay out; that the Theta well No. 2 and the Viola M. Griblin-B well No. 1, which are in a direct north and south line, tend to show that the probabilities are that there was no Bartlesville sand under the lease involved herein; that the respondent drilled well No. 1, on the Viola M. Griblin-B lease because there was a large undeveloped area be-

tween the two pools and that it went between the two pools to see whether or not there was any connection or production between them, and that said well No. 1 on the Viola M. Griblin-B lease showed there was not enough oil to pay; that said well and the history of it had a great deal to do with the respondent not having drilled additional wells on the lease involved; that the two aforesaid wells tended to prove that there was either no oil or oil in too small quantities to pay in the Mississippi lime under the lease involved; that taking into consideration the facts shown on the map introduced in evidence as petitioners' Exhibit No. 1, in his opinion the sand from which the wells east of the lease involved were producing, like the sand in all oil producing areas in that part of Kansas, was a long narrow strip, that one usually got better results by drilling in the middle of that line of sand and that by going either east or west from the middle the wells were usually smaller; that all of the wells to the west of the premises involved herein were producing from the Mississippi lime, but all of said wells were drilled through the Bartlesville sand or where the Bartlesville sand is ordinarily encountered, and that none of said wells ever produced from the Bartlesville sand; that well No. 1, on the premises involved herein was located in the extreme southwest corner of said premises, and that the initial production of said well was approximately 75 barrels; that well No. 2 on the premises involved was to the east of well No. 1 and that the initial production of said well was approximately 20 barrels; that that indicated that if the respondent had extended development further east on the premises involved it would have gotten a dry hole; that taking into consideration the development

both upon the lease involved herein and upon all the surrounding leases, both east and west and north and south, the cost of drilling and equipping a well in that locality and the probability of encountering paying production, and all other available facts, it was his opinion that no prudent operator would have drilled another well on the premises involved; that the respondent had never abandoned or intended to abandon any portion of its lease; that if the future should prove it practical to drill another well on said lease respondent was capable and willing to drill it; that there was a dry hole on the Florence Oil Company lease to the west of the lease involved, just one location therefrom; that said well was drilled to the Mississippi lime and through where the Bartlesville sand should have been encountered; that there was a dry hole drilled on the East Half (E2) of the Northwest Quarter (NW4) of Section 16 by the Syndicate Oil Company, and that said well was drilled through where the Bartlesville sand should have been to the Mississippi lime, and that said well was a little more than one location from the lease involved; that said wells indicated that it was improbable that oil could be obtained on the lease involved; that oil was discovered in paying quantities in each of the two wells drilled on the lease involved and that said wells had been continuously operated down to the present time and were still being operated; that said wells had at all times produced, and were at the time of the trial producing oil in sufficient quantities to produce a profit over and above the cost of operation; that none of the wells located to the east of the lease involved was what is known as an "offset" well, and that the usual location distance from the line for wells in this

vicinity was approximately 200 feet; that the usual distance between wells was approximately 500 feet or a little more, and that none of the wells drilled along the east line of the lease involved was within 500 feet of the east line of said lease; and that there was sufficient space for the location of another well between each of said wells and the east line of said lease (R. 47-54).

LLOYD SNYDER testified that he had charge of the operation of the lease involved and that he had been superintendent of production for the respondent in this particular locality for thirteen years; that he had been engaged in drilling and operating oil wells for about 33 years; that he was familiar with the wells which had been drilled to the east of the lease involved and that said wells were not close enough to the lease involved to be what are commonly called "offset" wells to said lease; that the closest producing well to the east line of said lease was well No. 4 on the Shaffer & Howell lease and it was 660 feet from the east line of the lease involved; that the usual distance between wells in the locality of the lease involved was 460 feet, staying 200 feet from county lines and lease lines; that the wells to the east of the lease involved were producing from the Bartlesville sand and that the wells to the west and southwest of said lease were producing from the first break in the Mississippi lime, which was below the Bartlesville sand; that the respondent herein owns a lease on the Southwest Quarter (SW4) of Section 15, the Shadel lease, and that the respondent had not extended its development further west on said lease because in his opinion no prudent operator would have developed it further west and that he based his opinion upon the water encroachment and the thickness

of the sand; that in drilling the wells on said lease as they went further west on the shoe string line of sand they developed more water and that was an indication that the producing sand was playing out; that in his opinion it would not have been profitable to have drilled an additional well on any portion of the premises involved herein and that if additional wells had been drilled on said lease oil or gas would not have been discovered in such quantities as to have paid the cost of drilling, together with a reasonable profit on that outlay, and that in his opinion no prudent operator would have drilled an additional well on said lease; that well No. 1 on the lease involved showed an initial production of 75 barrels and a certain thickness of sand; that well No. 2 to the east of said well No. 1 showed a thin sand and a very small amount of oil and from these facts he reached the conclusion that if they had gone further east they would have gotten the lime and it would have been non-productive; that the well on the Viola M. Griblin-B lease in the Northeast Quarter (NE4) of Section 21, was drilled through the Bartlesville sand into the Mississippi lime; that it did not produce oil in paying quantities and that in his opinion it would never pay out; that the well immediately north of said well on the Theta Oil Company lease covering the Southeast Quarter (SE4) of Section 9 was a dry hole and that said well was drilled through the Bartlesville sand into the Mississippi lime; that the aforesaid two wells had a tendency to show that the lime oil did not extend that far west on the lease involved and that the sand was missing in both of said wells; that said wells showed that in that direct line north and south oil could not be found in paying quantities, either in the Bartlesville

sand or in the Mississippi lime; that there were no "offsets" to the lease involved, except the two wells on the Griblin-A lease and the Florence Oil Company lease, which had been offset by the respondent; that in his opinion it would not have been a prudent idea to have drilled any other "offset" well to the lease involved; that Shaffer & Howell owned the lease to the north of the Shadel lease, which said lease adjoined the lease involved on the east, and that they had laid back from the line of the lease involved about 660 feet; that the respondent and Shaffer & Howell did not have and never talked of any agreement to lay back from the line and not give Mr. Sauder an offset well; that Shaffer & Howell used the same theory that prudent operators would use; that the respondent did not drill a well to the north of well No. 1 on the lease involved because it would have been an offset to a dry hole; that from a geologist's point of view, the apparent trend, which came toward the lease involved from the southwest, seemed to stop before it reached the lease involved; that he did not think that the wells surrounding the lease involved that had been pumping from 8 to 11 years were draining oil from under the lease involved; that he did not think there was any producing sand under the lease involved, but that even if there was oil under said lease, from the location of the wells on adjoining premises said wells would not drain the oil from underneath the lease involved; that the wells around the lease involved might possibly lower the pressure; that whether or not drilling an "offset" to a producing well would lower the production of the producing well depended upon the body of sand it was producing from and whether it was a small body of sand or a large one; that he would consider the body of

sand to the east of the lease involved a very small body of sand; that he did not consider the respondent had been draining oil from under the lease involved; that for perfect drainage wells were placed 460 feet apart and 200 feet from the lease lines, and that there had been no wells drilled on adjoining property that would drain the lease involved; that in the 33 years he had been engaged in the oil business he had never heard of any oil field in which the producing sand did not at some place play out and that he had never heard of any oil sand that did not have definite limits; that the wells to the southwest of the lease involved were producing from the Mississippi lime and that in drilling said wells no Bartlesville sand was found; that some of the wells to the northeast of the lease involved were producing from the Bartlesville sand and some from the Mississippi lime; and that there was nothing to indicate any connection between the wells to the southwest and those to the northeast of the involved lease (R. 54-59).

L. J. YOUNG, a graduate of geology at the University of Michigan, testified that he had been employed as a geologist by the respondent for 10 years; that he had personally examined the logs of the wells that had been drilled in the immediate vicinity of the lands involved herein; that he had prepared a map or chart, respondent's Exhibit D, which appears at page 73 of the record, showing the location and trend of the sand from which the wells to the east and to the northeast and to the southeast of the lease involved were producing; that said map was prepared from the logs of wells drilled in the vicinity of the lands involved herein; that the general direction of this sand was just a little east of north and that it was very narrow; that the

red lines on said map extending through the middle of the black lines indicate the crest or highest point at which the drillers found the sand in drilling the wells, and that in going either east or west from said red lines the sand is encountered at lower depths and that it showed a dip on the top of the Bartlesville sand, both to the east and to the west, from the center line; that the best wells were along the center line and that they decreased on each side as you went either east or west; that in his opinion, based upon an examination of the logs of the wells, the sand did not extend as far west as the lease involved; that he had indicated the lease involved on said Exhibit D by green pencil marks; that he had also prepared a map or chart showing the location and trend of the Mississippi lime in the locality of the involved lease, which was introduced in evidence as respondent's Exhibit E and appears in the record at page 77; that the black lines on said map were the contour lines on the top of the Mississippi lime and that the map was prepared for the purpose of showing the subsurface condition, particularly with reference to the Mississippi lime, in the locality of the lease involved; that said map was prepared from the logs of the wells drilled in the vicinity; that the lease involved was shown on said map in green crayon; that he had also shown the location and trend of the Bartlesville sand on said map by drawing two red lines and that the production from the Bartlesville sand was within those lines. Referring to wells Nos. 1 and 2 on the lease involved and well No. 1 on the Florence Oil Company lease to the west of the lease involved, the map showed a dip of 15 feet on the top of the Mississippi lime between those three wells, going down toward the east or

toward well No. 2 on the lease involved; that the dry hole on the Florence Oil Company lease on the Southeast Quarter (SE4) of the Northwest Quarter (NW4) of Section 16 was 32 feet lower on the top of the Mississippi lime than well No. 1 on the lease involved; that the lime under the lease involved was low and that it dipped in every direction except from the northwest to the southeast; that the production from the Mississippi lime was obtained where the lime was encountered at high points and the dry holes were obtained where the lime was encountered at low points; that in his opinion no paying production could be obtained from the Mississippi lime at any point on the lease involved other than at the location of the two wells that had been drilled on said lease because the lease lies too low on the top of the Mississippi lime for production; that he could not see any reason for thinking there was any oil at all on the lease involved; that the Bartlesville sand did not extend far enough to the west to come to said lease; and that there was nothing to indicate that there was a trend in the Mississippi lime under said lease (R. 59-63).

S. V. BROWN, superintendent of the Shaffer & Howell Drilling Company, which owned the lease covering the Northwest Quarter (NW4) of Section 15, adjoining the lease involved on the east, testified that he had been superintendent of the Shaffer & Howell Drilling Company for a little more than 10 years; that he had drilled all of the 15 wells on that lease with the exception of two and that he had drilled quite a number of wells to the north of the lease involved; that he had charge of the operation of the wells on the Shaffer & Howell lease and had determined the location for all of the wells on said lease, with the exception

of the first four wells; that well No. 4 on said lease was the closest well to the east line of the lease involved; that it was located in the northwest corner of the Shaffer & Howell lease; that it had an initial production of 60 barrels; that he did not know whether or not said well had paid out; that none of the wells located on said lease was an "offset" to the lease involved; that the regular offset distance in this field was 200 feet from the property line; that there was room for approximately five or six locations along the west side of the Shaffer & Howell lease that had not been drilled for the reason that the Bartlesville sand did not extend to said locations; that the Theta Oil Company well in Section 9 proved that the Bartlesville sand did not extend far enough to the west to justify the drilling of those locations; that the trend of the sand on the Shaffer & Howell lease ran from the southeast to the northwest and that in his opinion there was no Bartlesville sand under the lease involved; that it would be necessary to find lime oil under the lands involved in larger quantities than he had found it on the Shaffer & Howell lease to pay for the drilling of a well; that in his opinion a reasonably prudent oil man would not drill an additional well on the lease involved; that the closest he had ever drilled to the lease involved was 660 feet from the east line; and that there was no agreement of any kind between Shaffer & Howell and the respondent (R. 64-65).

Each of the respondent's aforesaid witnesses frankly admitted that he might be mistaken in his opinion that oil in paying quantities could not be discovered in any additional well upon petitioners' land, and that he was simply giving his opinion based upon the past developments. And

said witnesses further testified that future developments around the northwest corner of said lands might justify the drilling of additional wells thereon (R. 52, 56, 62).

The foregoing uncontradicted evidence of the respondent conclusively establishes that the wells on the premises adjoining the lease involved herein have not drained, were not draining and were not likely to drain oil from under said lease; that if any additional well or wells had been drilled on said lease said wells would probably not have produced oil or gas in paying quantities, or, in other words, in sufficient quantities to have repaid the cost of drilling, equipping and operating such well or wells, together with a reasonable profit on the entire outlay, and that a reasonably prudent operator would not have drilled any additional well or wells upon said lease.

Petitioners' Request for Findings of Fact and Conclusions of Law.

The facts which the petitioners requested the trial court to find were not only insufficient to entitle them to any of the relief prayed for herein, but were such as to require said court to decide the case in favor of the respondent. For instance, the petitioners introduced no evidence as to drainage of oil from their lands by reason of wells on adjoining premises, but the respondent did, and the petitioners requested the trial court to find, which it did, that "the defendant introduced the evidence of expert witnesses who testified rather positively that in their judgment none of the production adjacent to the land described in this lease is draining any oil from plaintiffs' land," and further requested the trial court to find, which it did, that "this evi-

dence as to drainage is not wholly convincing to the court." Then, again, the petitioners contended, without introducing any evidence to that effect, that there was a well defined "trend" of oil producing sand and lime extending in a southwesterly-northeasterly direction under their land, and they requested the trial court to find, which it did, that "expert evidence introduced by the defendant tended to prove that no such 'trend' exists under and across the land described in said lease, but that on the contrary the oil sand is not to be found under said land and the depth of the lime under said land, as estimated by geologists, is so great that the probabilities are no oil would be found in it. On this point the court is unable to determine the facts; but finds that no positive evidence having been introduced by either party as to this contention of plaintiffs, that nothing but exploration and positive tests by drilling upon said land can settle the controversy as to whether oil or gas in paying quantities can be found upon said land." Furthermore, the petitioners did not request the trial court to find, nor did it find, that a reasonably prudent operator under the circumstances would have drilled any additional well upon the lands involved herein.

The Trial Court's Memorandum Decision.

At the conclusion of the trial, the trial court took the case under advisement, and subsequently filed herein its memorandum decision, which we presume was intended to embody said court's findings of fact and conclusions of law, as required by Equity Rule 70½, although the same is obviously not in the form contemplated by said rule. The pertinent facts found by the trial court in said memorandum

decision, and which are identical with the petitioners' request for findings of fact, are as follows:

"That within ten (10) years from the date of the execution, acknowledgment and delivery of the aforesaid oil and gas mining lease the defendant, Mid-Continent Petroleum Corporation, or its predecessors in title, drilled and completed two oil wells upon the above described real estate and premises, and that such wells were drilled as offsets to wells drilled and producing oil on an adjacent leasehold. Said two oil wells were drilled in the southwest quarter of the southeast quarter of the southwest quarter of said Section Sixteen (16) and at the extreme southwest corner of said leasehold; *that oil was discovered in each of said wells in paying quantities; and that at all times subsequent to the drilling and completion of said two wells the defendant, Mid-Continent Petroleum Corporation, or its predecessors in title, have produced oil in paying quantities from each of said wells; and said defendant, Mid-Continent Petroleum Corporation, is now producing oil in small but paying quantities from each of said wells.*

"That there has been oil development on lands adjacent to the real estate herein described, and that there are now and since about 1921 and 1922 have been many producing oil wells to the east and south bordering upon the real estate herein described, and to the southwest and the northeast on lands cornering with the land immediately east of the half section described in said lease there are approximately twenty-five producing oil wells; that upon the half section of land lying immediately south of said section there are approximately fifteen producing oil wells; that upon the quarter section cornering with the half section described in the lease to the south and east thereof there are approximately twelve producing oil wells; that west from the two offset wells drilled by the defendant upon the land described in said lease and upon the southwest quarter of said Section 16 there are three producing

oil wells; that on the half section cornering with the half section described in the lease to the northeast there is considerable oil production, but the record does not show the exact amount thereof; that directly north of said Section 16, but at considerable distance, there is oil production, but the evidence does not show the extent thereof.

"None of the oil wells referred to in the above finding are within four hundred feet of the property line of the land described in the lease with the exception of wells to the south which have been offset by the two wells drilled upon this property. *The defendant introduced the evidence of expert witnesses who testified rather positively that in their judgment none of the production adjacent to the land described in this lease is draining any oil from the plaintiff's land.* These witnesses, however, admitted that they might be mistaken as there was no absolute way of determining the question of drainage except by drilling tests. *This evidence as to drainage is not wholly convincing to the court.* There is, in the opinion of the court, some probability that damage is being done to this leasehold by drainage upon the adjoining properties.

"The defendant owns and is operating an oil lease on the south half of the half section lying immediately east of Section Sixteen (16) and the lease on the land cornering upon the south half of Section Sixteen (16) on the southeast, and the lease on the land on the south of said southeast quarter of the southwest quarter of said Section Sixteen (16) hereinbefore described.

"On the basis of the oil development and oil production upon adjacent lands, as shown by the evidence herein, plaintiffs contend that a well-defined 'trend' of oil producing sand and lime runs in a southwesterly-northeasterly direction under and across the land described in said lease. *Expert evidence introduced by the defendant tended to prove that no such 'trend' exists under and across the land described in said lease,*

but that on the contrary the oil sand is not to be found under said land and the depth of the lime under said land, as estimated by geologists, is so great that the probabilities are n oil would be found in it. On this point the court is unable to determine the facts but finds that no positive evidence having been introduced by either party as to this contention of plaintiffs, that nothing but exploration and positive test by drilling upon said land can settle the controversy as to whether oil and gas in paying quantities can be found upon said land. Neither the defendant nor any of its predecessors in title have drilled any well upon the east half of Section Sixteen (16) but no dry well has been drilled on any of the property covered by said lease." (R. 33-35)

It will be noted that the trial court nowhere found that there was any drainage from under the lands of the petitioners or that a reasonably prudent operator under the existing circumstances would have drilled any additional well upon said lands.

The Trial Court's Decrees.

On the 14th day of September, 1932, the trial court entered its decree cancelling respondent's lease, except insofar as it covered the premises upon which the two wells were located and a small portion of the premises surrounding said wells. And thereafter, on the 7th day of October, 1932, said court entered a second decree, which is identical with its aforesaid first decree, except that the respondent was permitted to leave upon the cancelled portion of its lease certain of its tanks, pipes and equipment used in connection with the operation of the two aforesaid wells, until such time as the location of said tanks, pipes and equipment should interfere with the operation and development

of the cancelled portion of said lease for oil and gas (R. 40-43).

Opinion of Circuit Court of Appeals.

In 67 F. (2d) 9, the Tenth Circuit Court of Appeals, Judge McDermott dissenting, reversed the above decree of the District Court, and the case is before this Court upon a writ of *certiorari*.

Petitioners' Contention.

In its final analysis petitioners' contention is that the lease involved herein imposed upon respondent an implied obligation to drill an additional well or wells upon the leased premises, notwithstanding the uncontradicted evidence herein that there was no reasonable probability that oil or gas in paying quantities would have been discovered therein, and notwithstanding the uncontradicted evidence that no reasonably prudent operator would have drilled such additional well or wells. In short, their contention is not that respondent was required to reasonably develop, but was required to unreasonably develop the premises herein.

While the petitioners say that the respondent was obligated to "diligently develop" the premises involved, it will be noted that they have wholly failed to lay down any test or standard for determining what is reasonable or diligent development. How many wells must be drilled? Where are they to be located? When are they to be drilled? Must a well be drilled at every location? How are the locations to be ascertained and determined? How deep is each well to be drilled? Who is to determine each of these things?

And upon what facts and circumstances or standard is the determination to be made? The petitioners answer none of these questions.

Respondent's Contention.

Respondent contends that its lease does not impose upon it any implied obligation to drill an additional well or wells upon the leased premises, in the absence of an affirmative showing that, under all the existing circumstances, there was a reasonable probability that oil or gas, in paying quantities, would have been discovered therein, or that a reasonably prudent operator would have drilled such additional well or wells.

The leading case of *Brewster* v. *Lanyon Zinc Co.*, (8 C. C. A.) 140 Fed. 801, which is a Kansas case, involving a lease on lands situated in Allen County, Kansas, sets forth clearly the tests for determining whether a breach of an implied covenant to drill oil or gas wells has been committed. In that case, as in the case at bar, the court was considering an implied covenant to continue exploration and development after the expiration of the fixed period of development, during which oil or gas had been found to exist in paying quantities. In said case Mr. Justice VAN DEVANTER, delivering the opinion of the Court, said:

> "Considering the migratory nature of oil and gas, and the danger of their being drawn off through wells on other lands if the field should become fully developed, all of which must have been in the minds of the parties, it is manifest that the terms of the lease contemplated action and diligence on the part of the lessee. There could not well have been an express stipulation as to the number of wells to be drilled, as to when

the wells, other than the first, should be drilled, or as to the rate at which the production therefrom should proceed, because these matters would depend in large measure upon future conditions, which could not be anticipated with certainty, such as the extent to which oil and gas, one or both, could be produced from the premises, as indicated by the first well and any others in the vicinity, the existence of a local market or demand therefor or the means of transporting them to a market, and the presence of wells on adjacent lands capable of diminishing or exhausting the supply in the natural reservoir. The subject was, therefore, rationally left to the implication, necessarily arising in the absence of express stipulation, that such further prosecution of the work should be along such lines as would be reasonably calculated to effectuate the controlling intention of the parties as manifested in the lease which was to make the extraction of oil and gas from the premises of mutual advantage and profit. * * *

"But, while this is so, no breach can occur save where the absence of such diligence is both certain and substantial in view of the actual circumstances at the time, as distinguished from mere expectations on the part of the lessor and conjecture on the part of mining enthusiasts. The large expense incident to the work of exploration and development, and the fact that the lessee must bear the loss if the operations are not successful, require that he proceed with due regard to his own interests, as well as those of the lessor. No obligation rests on him to carry the operations beyond the point where they will be profitable to him, even if some benefit to the lessor will result from them. It is only to the end that the oil and gas shall be extracted with benefit or profit to both that reasonable diligence is required. Whether or not in any particular instance such diligence is exercised depends upon a variety of circumstances, such as the quantity of oil and gas capable of being produced from the premises, as indicated by prior exploration and development, the local mar

ket or demand therefor or the means of transporting them to market, the extent and results of the operations, if any, on adjacent lands, the character of the natural reservoir— whether such as to permit the drainage of a large area by each well—and the usages of the business. Whatever, in the circumstances, would be reasonably expected of operators of ordinary prudence, having regard to the interests of both lessor and lessee, is what is required. A plain and substantial disregard of this requirement constitutes a breach of the covenants for the exercise of reasonable diligence, which, as before shown, is also made a condition of the lease under consideration."

The defendant in the foregoing case took the position that there was no implied obligation, regardless of circumstances, to further develop after its discovery of gas in paying quantities. In the case at bar, however, the respondent concedes that, under various circumstances, there is such an obligation but contends that the evidence herein completely negatives the existence of any circumstances giving rise to same.

The foregoing case involved the action of the trial court in sustaining the defendant's demurrer to the plaintiffs' petition, and Mr. Justice VAN DEVANTER, after enumerating the allegations of said petition, said:

"*The necessary inference from what is stated is that further exploration and development would have been profitable to the lessee, as well as beneficial to the lessor.* In these circumstances the prolonged failure of the lessee to proceed with the contemplated operations, though due to a mistaken view of the obligations imposed by the lease, was a plain and substantial breach of the covenant and condition in respect of the exercise of reasonable diligence and entitled the lessor to terminate the lease."

And, in concluding the opinion, Mr. Justice VAN DEVANTER said:

> "It follows that, under the rule before stated, the lessor will be entitled to relief *only* in the event that the case made upon the hearing shall be, as is that made by the amended bill, one the equity of which is strong enough to overcome the general indisposition of courts of chancery towards aiding in the enforcement of forfeitures."

The lease in the foregoing case covered three non-contiguous tracts—separated from eight to fourteen miles—yet the Court clearly held that the one well, drilled on one of said tracts within the primary term of the lease, was sufficient to hold the entire leased premises, unless there had been a breach of the implied obligation to further develop. In this connection Mr. Justice VAN DEVANTER said:

> "The further position is taken in the bill that the lessor was entitled to avoid the lease, because it covers three tracts separated by distances of from 8 to 14 miles, and because no well was drilled on two of the tracts within five years. That is a matter in respect of which it was competent for the parties to stipulate, and in respect of which they did stipulate, as shown by the following clauses of the lease:
>
> '(7) Second party (the lessor) agrees to drill a well upon said premises within two years from this date, or thereafter pay to first party (the lessor) seventy-eight dollars annually until said well is drilled, or the property hereby granted is conveyed to the first party.'
>
> '(9) If no well shall be drilled upon said premises within five years from this date, second party agrees to reconvey, and thereupon this instrument shall be null and void.'

"The purpose and effect of these clauses was plainly *(1)* to give the lessee two years within which to drill a well (not three wells, but one) upon the leased premises—not each tract, but the entire premises; *(2)* to enlarge that time, but not beyond five years, on condition that the lessee should pay an annual rental of $78 from the expiration of the second year until the well should be drilled; and *(3)* to entitle the lessor to a reconveyance of the premises if no well—none at all—should be drilled thereon within five years. Thus the measure of diligence which the lessee was required to exercise in prosecuting the work of exploration and development during the first five years was expressly and definitely prescribed, and was not left to any implication which otherwise might arise from the nature of the lease or from the other stipulations therein. It is appropriate to here refer to what was well said by the Supreme Court of Kansas, in disposing of a somewhat similar question, in the case of *Rose* v. *Lanyon Zinc Co.*, 68 Kan. 126, 74 Pac. 625:

> 'If plaintiffs should desire to contract for an immediate exploration, they must have that right; and if they should desire to give an oil or gas company five years in which to sink a well, upon a consideration satisfactory to themselves, and as the result of negotiations free from imposition and fraud, they must have that right. But, having deliberately made a contract of the latter description, they have no right to call upon a court to declare that it is of the other kind, merely because generally it might seem to be better for farmers not to incumber their lands with mineral leases, giving a long time for exploration, or because generally such leases do contemplate that forfeiture shall follow a failure to explore at once."

To the same effect see:

Texas Co. v. *Waggoner*, 239 S. W. (Tex. Civ. App.) 354;

Fisher v. *Crescent Oil Co.*, 178 S. W. (Tex. Civ App.) 905;

McCallister, et al., v. *Texas Co.*, 223 S. W. (Tex Civ. App.) 859;

Texas Co. v. *Curry*, 229 S. W. (Tex. Civ. App.) 643

Duke v. *Stewart*, 230 S. W. (Tex. Civ. App.) 485.

The *Brewster* case was decided in 1905, approximatel eleven years before the execution of the lease involved i the case at bar. Since that time it has been repeatedly cite and followed in Kansas and elsewhere. Probably no othe decision involving oil and gas law has been cited so frequent ly. Even Judge McDermott in his dissenting opinion herei is forced to admit that it "is undoubtedly the leading cas on the subject of implied covenants diligently to explor and develop." Strangely enough, considering his conclu sion herein, Judge McDermott also said: "As I read th decisions of the Kansas court, they adhere to the sam general test as announced in *Brewster* v. *Lanyon Zinc Co supra*, and followed by our court in *Denker* v. *Mid-Continen Petroleum Corporation*, 56 F. (2d) 725."

Likewise, the petitioners in their brief state that "th decisions of the Kansas court adhere to the same genera test as announced in *Brewster* v. *Lanyon Zinc Co.*, (C .C. A 8) 140 Fed. 801."

At least three of the Kansas cases upon which the peti tioners rely, to-wit: *Howerton* v. *Gas Co.*, 81 Kan. 553, 10 Pac. 47; *Alford* v. *Dennis*, 102 Kan. 403, 170 Pac. 1005 and *Webb* v. *Croft*, 120 Kan. 654, 244 Pac. 1033, cited an follow the *Brewster* case.

In *Webb* v. *Croft*, *supra*, one of the two cases which th

trial court cites as supporting its conclusion herein, and which we insist is opposed thereto, the Court said:

> "Defendants contend that as they had kept the lease alive by drilling one well during the lease period and had paid the accrued rentals and royalties, the court was not warranted in requiring further development, and that it therefore had read into the contract conditions not stipulated by the parties and had placed burdens on the defendants not contemplated by the contract. Leases of this kind contemplate exploration and development, and not the bottling up of land for speculative or other purposes or the postponement of reasonable development, nor yet the limiting of development to an extent merely to prevent a declaration of forfeiture. Although not expressly mentioned in the lease, there is an implied covenant or condition that there shall be reasonable development and such operation as will protect the interests of both lessor and the lessee. *Howerton* v. *Gas Co.*, 106 P. 47, 81 Kan. 553, 34 L. R. A. (n.s.) 34; *Id.*, 106 P. 813, 82 Kan. 367, 34 L. R. A. (n.s.) 46; *Alford* v. *Dennis*, 170 Pac. 1005, 102 Kan. 403; *Harris* v. *Ohio Oil Co.*, 48 N. E. 502, 57 Oh. St. 118. The lease is silent as to the number of wells that shall be drilled on the land, and in such a case there is an implication that there shall be reasonable development of the land by *drilling such number of wells as an ordinary prudent man would do under the circumstances, taking into consideration the results of the development and whether or not there was a sufficient production to warrant the continuance of exploration and drilling.*"

The authorities announce two tests of compliance with the implied covenants of an oil and gas lease. The weaker of the two tests is referred to as the "good faith" standard and is applied by many of the federal courts and the courts of Pennsylvania, West Virginia, Kentucky and possibly oth-

er courts. According to this standard, all that is required of the lessee is that he act "in good faith on his business judgment", the courts having no power "to impose a different judgment on him, however erroneous it may deem his to be", and before the lease will be cancelled it is practically necessary to show that the lessee is acting "fraudulently with intent to obtain a dishonest advantage over the other party to the contract". The other and stronger test is referred to as the "ordinarily prudent operator" standard. This latter test is the one announced by the *Brewster* case and is the practically universal rule.

Mr. Merrill, in his Covenants Implied in Oil and Gas Leases, page 192, in referring to the ordinarily prudent operator standard, says:

> "What the conduct of this ordinarily prudent operator would be must depend upon many conditions. The lessee is certainly not required to engage in a losing venture merely on the chance of obtaining an increase in royalty for his lessor. So he is not required to engage in further development where he has already made heavy expenditures and it appears that additional wells would not be profitable. The abandonment of unprofitable wells is not a violation of the lessee's obligation to operate the premises, and he is not required to drill an offset well if it appears that it will not be sufficiently productive to repay the cost of drilling and operation."

In the case of *Goodwin* v. *Standard Oil Co. of Louisiana*, 290 Fed. 92, the Circuit Court of Appeals for the Eighth Circuit held:

> "In an action for the cancellation of oil and gas lease and damages for breach of implied covenant to

drill protection wells, the burden is on the plaintiff to prove the want of due diligence on the part of the lessees in drilling such offset well."

In said case the Court also held:

"Though a lessee, not guilty of fraud or bad faith, may be liable for failure to exercise reasonable diligence in drilling protection wells, and though the lease contains no express requirement, yet no breach of an implied covenant can occur except where the absence of such diligence on the part of the lessee is both certain and substantial, in view of the actual circumstances at the time as distinguished from mere expectations on the part of lessor and conjecture on the part of mining enthusiasts, the expense of exploration and development, and the fact that lessee must bear the loss of unsuccessful operation, entitle him to proceed with due regard for his own interests, as well as those of the lessor.

"Evidence that lessees began the drilling of the leased property within two months after the completion of the first well drilled on land adjoining the lease, and that within two months thereafter the defendants commenced the drilling of other offset wells, and that when completed the wells produced gas, but no oil, *held*, with other evidence as to the production on adjoining land, and the expense of well drilling, and the entire lack of market for gas, not to show such absence of reasonable diligence on the part of lessee as to drilling protection wells as was both certain and substantial, such as would warrant cancellation of the lease."

In the case of *Orr* v. *Comar Oil Co.*, 46 F. (2d) (10 C. C. A.) 59, the Court held:

"Burden is upon lessor to show that lessee, under implied covenant, failed to exercise reasonable diligence in drilling offset wells."

In the case of *Smith* v. *M Hill, et al.*, 12 F. (2d) (8 C. C. A.) 32, the Court held:

> "Lessor in oil and gas lease, alleging that lessee had failed to comply with conditions of lease in finding gas and oil in paying quantities within term, has burden of proof thereof."

The first paragraph of the syllabus to the case of *Denker* v. *Mid-Continent Petroleum Corporation*, 56 F. (2d) (10 C. C. A.) 725, reads as follows:

> "To comply with implied covenants to drill offset wells and diligently develop lease, lessee must do what operator of ordinary prudence, having regard to interests of both lessor and lessee, would do."

In the body of the opinion Judge PHILLIPS, speaking for the Court, said:

> "In order to comply with the implied covenants of a lease to drill offset wells and to diligently develop the lease, a lessee must do that which, under the circumstances, an operator of ordinary prudence, having regard to the interests of both lessor and lessee, would do. *Brewster* v. *Lanyon Zinc Co.*, (C. C. A. 8) 140 F. 810; *Pelham Petroleum Co.* v. *North*, 78 Okl. 39, 188 P. 1069, 1072; *Goodwin* v. *Standard Oil Co.*, (C. C. A. 8) 290 Fed. 92; *Humphreys Oil Co.* v. *Tatum*, (C. C. A. 5) 26 F. (2d) 892; *Orr* v. *Comar Oil Co.*, (C. C. A. 10) 46 F. (2d) 59, 63; 40 C. J., p. 1067, Sec. 684."

The case of *Cosden Oil Company* v. *Scarborough*, 55 F. (2d) (5 C. C. A.) 634, was an action to cancel an oil and gas mining lease insofar as the same covered 400 acres. The lease involved covered 10,254 acres and was assigned by the original lessee to Cosden Oil Company insofar as it covered the 400 acres involved therein. Twelve wells had

been drilled on the 10,254 acres but no wells had been drilled upon the 400-acre tract. The Court, under these circumstances, held:

> "Implied covenant of oil and gas lease, arising after initial production of oil is obtained, imposes no absolute duty of development, but one measured solely by standard of diligence.
>
> "Test in determining whether implied covenant to develop oil and gas lease has been performed, is whether ordinarily prudent person would, under same or similar circumstances, cause drilling to be done."

In the opinion of the Court Judge HUTCHESON said:

> "Plaintiff pleaded, its testimony established, and the court found, that there was no way to tell in that territory whether oil and gas could be profitably produced without drilling for it. * * * Plaintiff offered no testimony of any person that a reasonably prudent operator, having in mind the interests of both lessor and lessee, would in the exercise of due diligence under the conditions prevailing, be justified in expending the sums necessary to drill a well on the property, nor did he offer any proof either by way of opinion evidence, or by way of evidence of persons who were willing, if given the chance, to so develop, that it would, under prevailing conditions, be a prudent thing to do. Defendant in addition to offering the testimony as to the actual results of operations in the territory, offered many witnesses, all practical oil men, who testified that, under conditions prevailing prior to and at the time of the suit, it could not be reasonably expected that anything but loss would come from drilling on its holdings. This proof established that it would be not a prudent, but a very imprudent operation to drill a well at this time, not so much because oil might not be found, as because if found, with the prevailing price and the small quantity of oil, it would not repay the

cost of development. Defendant offered proof, however, that it had not abandoned the lease; that it did intend to develop it when conditions became better, or if other operations in the territory furnished better ground for believing that a well could be profitably drilled. In short, their proof established that they had neither abandoned the property nor ceased operations upon it; that they were not operating on it now because it was not prudent to do so, but that as soon as prudent operation justified development, they would develop it.

"In Summers on Oil & Gas, pp. 434, 435, it is said: 'If the alleged breach of duty is upon the theory that the lessee has not drilled sufficient wells to secure all the oil and gas under the demised lands, then the lessor must prove that the drilling of additional wells is necessary, and that such wells may be reasonably expected, under all the circumstances, to be profitable to the lessee over and above all cost of drilling, operating and marketing the production.'

"This states the rule obtaining in Texas and generally elsewhere. *Texas Pacific Coal & Oil Co.* v. *Barker,* 117 Tex. 418, 6 S. W. (2d) 1031, 60 A. L. R. 936; *State Line Oil & Gas Co.* v. *Thomas,* (Tex. Civ. App.) 35 S. W. (2d) 746; *Brewster* v. *Lanyon Zinc Co.,* (C. C. A.) 140 F. 801; *Watchorn* v. *Roxana Petroleum Corp.,* (C. C. A.) 5 F. (2d) 636; *Texas Pac. Coal & Oil Co.* v. *Stuard,* (Tex. Civ. App.) 7 S. W. (2d) 878.

"The implied covenant springing after initial production obtained imposes no absolute duty of development, but one measured solely by the standard of diligence. The final test in every instance, to be applied by the court or jury trying the case, is whether an ordinary prudent person, having his covenant to develop and the interests of both lessor and lessee in mind, would, under the same or similar circumstances, cause drilling to be done. This test rejects the view erroneously advanced in some earlier Texas decisions (*Masterson* v. *Amarillo Oil Co.,* (Tex. Civ. App.) 253

S. W. 908; *Texas & Pacific Coal & Oil Co.* v. *Stuard,* (Tex. Civ. App.) 269 S. W. 482) that the lessee, if he acts in good faith, may be permitted to determine the extent of the diligence, with which development shall proceed, in favor of the view that it is for the court or jury trying the case to determine whether, under all the circumstances, including the cost of drilling and the probable profit therefrom, an ordinarily prudent person would have prosecuted development. *Texas & Pacific Coal & Oil Co.* v. *Barker, supra.* The fact that appellant has spent no money in development upon the 400 acres does not differentiate this case in principle from *Leonard* v. *Prater, supra,* where the lessee had. Large sums of money, much greater than were spent in *Leonard* v. *Prater* contributed in part by appellant and others, were spent by the lessee in drilling the first well. Other operators, at great cost and loss, have expended money in developing that territory, which has so far proven unprofitable. Appellant had the right, as an ordinarily prudent person, to take those developments and their result into consideration in determining what it should do. It was the duty of the court below, it is our duty, in applying the test, to consider them."

The identical question under consideration was before the Supreme Court of Oklahoma in the quite recent case of *Franklin, et al.,* v. *Wigton,* 132 Okl. 236, 270 Pac. 1, the second paragraph of the syllabus of which reads as follows:

> "A lessee of an oil and gas lease, upon an implied covenant to prevent drainage, is not required to drill an offset well unless oil or gas is found on adjacent lands, near the boundary line of lessors' land *in sufficient quantities to pay a reasonable profit on the whole sum required to be expended,* including the cost of drilling, equipping and operating the well."

In the course of the opinion in said case the Court said:

"As to the second cause of action, we are of the opinion that the demurrer to plaintiffs' evidence was properly sustained. The evidence discloses that a well was drilled 150 feet east of the line of plaintiffs' premises in which there was some showing of gas. There is no evidence as to the quantity produced; no evidence that gas was ever marketed from the well; no evidence whatsoever from which it could be inferred that the well was a paying well. In these circumstances, defendant was not required to offset this well. Before plaintiffs would be entitled to an offset it was incumbent upon them to show by some evidence that it was proable that a paying well could have been drilled. *Eastern Oklahoma Oil Co.* v. *Beatty, et al.*, 71 Okl. 275, 177 Pac. 105; *Pelham Petroleum Co.* v. *North*, 78 Okl. 39, 188 Pac. 1069.

"In the case of *Pelham Petroleum Co.* v. *North, supra*, this Court says:

> 'A stipulation in an oil and gas lease whereby the lessee obligates itself "to protect the side lines in case oil is found in paying quantities" imposes upon the lessee the same obligation to protect the lessor's land from actual or threatened drainage that the courts universally hold to be upon it in the absence of express stipulation to that effect. The provision means that the lessee is required to drill an offset well in case oil is found on adjacent lands near the boundary line of lessor's land in sufficient quantities to pay a reasonable profit on the whole sum required to be expended, including the cost of drilling, equipping and operating the well.'

"Under these authorities, the court was correct in sustaining the demurrer."

In the still more recent case of *Robinson, et al.*, v. *Miracle, et al.*, 146 Okl. 31, 293 Pac. 211, the Supreme Court of Oklahoma said:

"It is well settled in this jurisdiction that there is an implied covenant, in oil and gas mining lease contracts which contain no specific provision providing for the number of wells to be drilled in case paying production is discovered, to operate diligently and develop oil and gas lease premises after paying production has been discovered for the mutual benefit or profit for both lessor and lessee, and neither is, in the absence of a stipulation to that effect, the arbiter of the extent to which or the diligence with which the operation shall proceed, but both are bound by the standard of what in the circumstances would be reasonably expected of an operator of ordinary prudence having regard to the interest of both. Equity abhors forfeitures, but will, where justice requires, cancel a lease contract by reason of the lessee's failure diligently to produce and develop the premises. *Brewster* v. *Lanyon Zinc Co.*, (8th C. C.) 140 Fed. 801; *Indiana Oil, Gas & Development Co.* v. *McCrory*, 42 Okl. 136, 140 Pac. 610; *New State Oil & Gas Co.* v. *Dunn*, 75 Okl. 141, 182 Pac. 514; *Strange* v. *Hicks*, 78 Okl. 1, 188 Pac. 347; *Pelham Petroleum Co.* v. *North*, 78 Okl. 39, 188 Pac. 1069; *Gypsy Oil Co.* v. *Cover*, 78 Okl. 158, 189 Pac. 540; *Wapa Oil & Development Co.* v. *McBride*, 84 Okl. 184, 201 Pac. 984; *Papoose Oil Co.* v. *Rainey*, 89 Okl. 110, 213 Pac. 882; *Mistletoe Oil & Gas Co.* v. *Revelle*, 117 Okl. 144, 245 Pac. 620; *Scott* v. *Price*, 123 Okl. 172, 247 Pac. 103; *Fox Petroleum Co.* v. *Booker*, 123 Okl. 276, 253 Pac. 33; Merrill, Covenants Implied in Oil and Gas Leases, sections 3, 43, 44, 48, 53, 117. This is as well true where gas production is had as when the paying production discovered is oil. *Blackwell Oil & Gas Co.* v. *Whiteside*, 71 Okl. 41, 174 Pac. 573; *Donaldson* v. *Josey Oil Co.*, 106 Okl. 11, 232 Pac. 821; *Carder* v. *Blackwell Oil & Gas Co.*, 83 Okl. 243, 201 Pac. 252. Each time an effort is made to cancel a lease for breach of the implied covenant to diligently develop and produce oil and gas lease premises is controlled by its own facts. Neither lessor nor lessee may presume arbitrarily to determine

of what diligence should consist, what a reasonable operator should do under the circumstances, having in mind that the purpose of the contract is the mutual benefit of the landowner and the operator, that the landowner might receive within a reasonable time the benefits, the profits, from the minerals which may be extracted from under his premises, and that the operator might make a profit on his operations of the premises. *The lessee is not required to drill additional wells where the probability of his making a profit on the further operations is small.* However, the lessee will not be permitted to delay unduly further drilling operations after production is obtained *because of his caprice and arbitrary determination* that he could make more money by deferring his future drilling operations. As was said in *Brewster* v. *Lanyon Zinc Co., supra:*

> 'Whether or not in any particular instance such diligence is exercised depends upon a variety of circumstances, such as the quantity of oil and gas capable of being produced from the premises, as indicated by prior exploration and development, the local market or demand therefor or the means of transporting them to market, the extent and results of the operations, if any, on adjacent lands, the character of the natural reservoir—whether such as to permit the drainage of a large area by each well—and the usages of the business. *Whatever, in the circumstances, would be reasonably expected of operators of ordinary prudence, having regard to the interests of both lessor and lessee, is what is required.'*

"In the instant case there are no producing wells draining that portion of the lease which the court cancelled. However, the court found under the evidence that the lessees, in view of all the circumstances obtaining, had failed to diligently develop and operate the full lease, and had for all practical purposes abandoned the lease except the 40 acres on which the pro-

ducing well is located. We cannot say that this determination is against the clear weight of the evidence so the judgment thereon will be affirmed."

In the case of *Empire Gas & Fuel Co.* v. *Haggard*, 152 Okl. 35, 3 P. (2d) 675, which is the most recent Oklahoma case which we have found on the subject, the Supreme Court of Oklahoma said:

> "Speaking on the question of the duty of the lessee to continue operations, the Circuit Court of Appeals, in the case of *Brewster* v. *Lanyon Zinc Company*, 140 Fed. 801, said:
>
> > *'No obligation rests on him to carry the operations beyond the point where they will be profitable to him, even if some benefit to the lessor will result from them.'*
>
> "See, also: *Goodwin* v. *Standard Oil Co.*, 290 Fed. 92 (1923); *Indiana Oil Co.* v. *McCrory*, 140 Pac. 610; 42 Okl. 136; *United Central Oil Corp.* v. *Helm*, 11 Fed. (2d) 760."

In the case of *Gypsy Oil Co.* v. *Cover, et al.*, 78 Okl. 158, 189 Pac. 540, there was involved an oil and gas mining lease covering 160 acres of land, 120 acres thereof being contiguous, and the other 40-acre tract being located one-half mile therefrom. The lease was for a term of five years, and as long thereafter as oil or gas was produced therefrom. The lessee assigned the lease as to the aforesaid 40-acre tract, and the assignee within the primary term of the lease brought in a producing well thereon. No well whatsoever was drilled on the 160-acre tract, but, notwithstanding this fact, it was held that the one well on the 40-acre tract kept the lease alive during and beyond the primary term thereof as to the whole lease, or, in other words, both as to the 40-

acre tract and the 120-acre tract. In the course of the opinion in said case the Court said:

"It is admitted that one producing well was put down by Davis and the Producers' Oil Company within one year from the date of the lease; also that no well was drilled on the 120-acre tract or rentals paid. This court held in the case of *Roach* v. *Junction Oil & Gas Co.*, 179 Pac. 935, that after gas was found upon the leased premises within five years from date thereof in paying quantities, the lessee thereby became vested with a limited estate in the leased premises for further operations in accordance with the terms of the lease—citing *Brennan* v. *Hunter*, 172 Pac. 49, citing numerous cases. * * * We are aware that this court has held that oil and gas leases will be so construed as to promote development and prevent delayed unproductiveness. *Parafine Oil Co.* v. *Cruce*, 162 Pac. 816; *New State Oil & Gas Co.* v. *Dunn*, 75 Okl. 141, 182 Pac. 514; and *Curtis* v. *Harris*, 184 Pac. 574, not yet officially reported. This court has also held that a court of equity will, where necessary, decree forfeiture of oil and gas leases on account of a breach of an implied covenant to diligently operate and develop the property when such forfeiture will perpetuate justice (*Ind. Oil & Gas Co.* v. *McCrory*, 42 Okl. 136, 140 Pac. 610; *Blackwell Oil & Gas Co.* v. *Whitesides*, 174 Pac. 573), and such has been the holding of the federal courts in numerous cases, the leading case being that of *Brewster* v. *Lanyon Zinc Co.*, 140 Pac. 801, 72 C. C. A. 213. This lease was for a period of five years from date and as long thereafter as oil and gas or either of them is produced from the premises by the lessees, its successors or assigns.

"This lessee agreed to complete a well on the premises within one year or pay at the rate of $160 in advance for each additional twelve months completion is delayed until a well is completed. The lease contains no covenant as to the number of wells to be drilled on

the premises. The lease contains no express stipulation that anything should be done in the way of drilling for and producing oil and gas after the first five years. We think the rule announced by this court in the cases cited *supra* is the rule to be applied here, which is thus stated in the *Brewster* case:

> 'There could not well have been an express stipulation as to the number of wells to be drilled, as to when the wells, other than the first, should be drilled, or as to the rate at which the production therefrom should proceed, because these matters would depend in large measure upon future conditions, which could not be anticipated with certainty, such as the extent to which oil and gas, one or both, could be produced from the premises, as indicated by the first well and any others in the vicinity, the existence of a local market or demand therefor or the means of transporting them to a market, and the presence of wells on adjacent lands capable of diminishing or exhausting the supply in the natural reservoir. The subject was therefore rationally left to the implication, necessarily arising in the absence of express stipulation, that the further prosecution of the work should be along such lines as would be reasonably calculated to effectuate the confrolling intention of the parties as manifested in the lease, which was to make the extraction of oil and gas from the premises of mutual advantage and profit. Even in respect of the first well, if oil or gas was found in paying quantity, there was no express engagments to operate it; but that it was intended to be operated was plainly implied in the engagement to pay royalties to be gauged according to the production of oil and the use of gas. Whatever is necessary to the accomplishment of that which is expressly contracted to be done is part and parcel of the contract, though not specified. * * *'

"With these rules in mind, let us examine the circumstances surrounding the parties as disclosed by the record for the purpose of supplying the rules to the facts. The finding of the trial court was as follows:

> 'The court finds that the plaintiffs are the owners of the land in controversy and went in possession of the premises at the time of taking said deed, Exhibit No. 1, and have retained possession of the land since that date.'

"The facts thus found would not be sufficient to authorize the court to cancel the lease for a breach of an implied covenant to diligently operate and develop the premises. Concerning that matter, the learned judge in the opinion in the *Brewster* case, *supra,* said:

> 'There can, therefore, be a breach of the covenant for the exercise of reasonable diligence, though the lessee be not guilty of fraud or bad faith. But, while this is so, no breach can occur save where the absence of such diligence is both certain and substantial in view of the actual circumstances at the time, as distinguished from mere expectations on the part of the lessor and conjecture on the part of mining enthusiasts. The large expense incident to the work of exploration and development, and the fact that lessee must bear the loss, if the operations are not successful, require that he proceed with due regard to his own interests, as well as those of the lessor. *No obligation rests on him to carry the operations beyond the point where they will be profitable to him, even if some benefit to the lessor will result from them.* It is only to the end that the oil and gas shall be extracted with benefit or profit to both that reasonable diligence is required. Whether or not in any particular instance such diligence is exercised depends upon a variety of circumstances, such as the quantity of oil and gas capable of being produced from the premises, as indicated by prior

> exploration and development, the local market or demand therefor, or the means of transporting them to market, the extent and results of the operations, if any, on adjacent lands, the character of the natural reservoir—whether such as to permit the drainage of a large area by each well—and the usages of the business. Whatever, in the circumstances, would be reasonably expected of operators of ordinary prudence, having regard to the interests of both lessor and lessee, is what is required'."

There is almost no end to the cases which could be cited to the same effect as the foregoing.

Inasmuch as it is admitted that the two wells drilled by the respondent upon the premises involved herein were drilled during the primary term of its lease, that oil was discovered in paying quantities in each of said wells, that at all times subsequent to the completion of said wells they had produced oil in paying quantities and were still so producing it necessarily follows that the respondent's lease was in full force and effect as to each and every part of the leased premises, unless it had abandoned some portion of the leased premises, or unless it had failed to drill some "offset" well, which it was required to drill, or unless a reasonably prudent operator, under the existing circumstances, would have drilled an additional well or wells upon the leased premises, and the burden was upon the petitioners to both plead and prove that some one of said conditions had transpired.

There is no allegation in the petitioners' bill that the respondent had ever abandoned any portion of the premises involved herein. Furthermore, there was no proof of any such abandonment and the trial court did not find that

there was any abandonment. Consequently the sole question involved was whether the respondent had breached the implied covenants of its lease with reference to further development of the leased premises.

It is extremely doubtful whether the allegations of the petitioners' bill are sufficient to constitute a charge that the respondent had violated either an express or an implied covenant of its lease. The most that can be said of said bill is that the petitioners allege that they are "informed and verily" believe that there "is grave danger" of drainage of oil from under the premises involved by reason of wells on adjoining premises and that the development upon lands adjacent to the lands covered by the respondent's lease "has made it practically certain that oil could have been discovered in paying quantities by the drilling" of additional wells on said lease. Perhaps these allegations are tantamount to an allegation that under the existing circumstances an operator of ordinary prudence, having regard to the interests of both lessor, and lessee, would have drilled an additional well or wells upon the premises involved herein, but we doubt it.

In any event the petitioners offered no evidence whatsoever that there were any "offset" wells upon any premises adjacent to the lands involved herein, save and except the two wells which it is admitted the respondent had offset, or that there were any wells upon adjoining premises which were draining or were likely to drain oil from under the premises involved herein, or that the drilling of additional wells upon said premises would have been profitable. On the contrary, counsel for the petitioners, in his opening statement to the court, stated that "it is impossible to tell whether a

development of this lease would have yielded profits." It is, therefore, clear that the petitioners wholly failed to discharge the burden of proof imposed upon them.

On the other hand, and although it was probably not required so to do, the respondent established by uncontradicted evidence that it had not abandoned any part of the premises involved herein, that none of the wells on adjoining premises was an "offset" to the lease involved herein, that it would in all probability have been unprofitable for it to have drilled any additional well or wells upon said lease, that no reasonably prudent operator, under the existing circumstances, would have drilled any such additional well or wells, and that the respondent was ready, able and willing to drill additional wells on said lease if future developments justified it.

The findings of the trial court are wholly insufficient to support its judgment and as a matter of fact are contrary thereto. In said findings said court found that the two wells upon the premises involved herein were drilled during the primary term of respondent's lease, that oil was discovered in each of said wells in paying quantities, that at all times subsequent to the completion of said two wells they had produced oil in paying quantities and were still so producing. Said court also found that while the respondent had introduced "the evidence of expert witnesses who testified rather positively that in their judgment none of the production adjacent to the land described in this lease is draining any oil from petitioners' land, "this evidence as to drainage is not wholly convincing to the court." Said court further found that neither the petitioners nor the respondent had introduced any positive evidence as to the contention of the

petitioners that there was a well defined trend of oil producing sand and lime under petitioners' land and that "on this point the court is unable to determine the facts" and "that nothing but exploration and positive tests by drilling upon said land can settle the controversy as to whether oil and gas in paying quantities can be found thereon." Nowhere in its said findings did said court find, as it was necessary for it to find, in order to justify the cancellation of the lease involved herein, that if additional wells had been drilled on the leased premises oil would have been discovered in paying quantities or that a reasonably prudent operator would have drilled any adidtional well or wells upon said premises, or that the respondents had failed to comply with any of the express or implied covenants or conditions of its lease. We, therefore, insist that the reversal of the decrees of the trial court was inevitable.

None of the Kansas cases, whether decided prior or subsequent to the execution of the lease involved herein, except certain *obiter dictum* in *McCarney v. Freel*, 121 Kan. 189, 246 Pac. 500, conflicts with respondent's contention, but, if anything, they support the same.

In support of their contention that the Kansas cases are contrary to respondent's contention and the holding of the Circuit Court of Appeals herein the petitioners cite: *Mills* v. *Hartz*, 77 Kan. 218, 94 Pac. 142; *Howerton* v. *Kansas Natural Gas Co.*, 81 Kan. 553, 106 Pac. 47; *Id.*, 82 Kan. 367, 108 Pac. 813; *Culbertson* v. *Cement Co.*, 87 Kan. 529, 125 Pac. 81; and *Day* v. *Kansas City Pipe Line Co.*, 87 Kan. 617, 125 Pac. 43, all decided prior to the execution and delivery of the lease involved herein; and *Alford* v. *Dennis*,

102 Kan 403, 170 Pac. 1005; *Webb* v. *Croft*, 120 Kan. 654, 244 Pac. 1033; and *McCarney* v. *Freel*, 121 Kan. 189, 246 Pac. 500, decided subsequent to the execution and delivery of said lease. None of said cases, however, with the exception of certain *dictum* in *McCarney* v. *Freel, supra,* supports petitioners' contention, but on the contrary all of said cases, with the exception of the aforesaid *dictum,* support the contention of the respondent and the holding of the Circuit Court of Appeals herein.

The Circuit Court of Appeals considered and reviewed the Kansas decisions, and after announcing the general rule with reference to the implied obligation of an oil and gas lessee to further develop, said:

> "This is the rule announced by the great weight of authority. *It has been approved by the Kansas decisions.* See *Webb* v. *Croft,* 120 Kan. 654, 244 Pac. 1033; *Howerton* v. *Kan. Nat. Gas Co.,* 81 Kan. 553, 106 Pac. 47; *Id.,* 82 Kan. 367, 108 Pac. 813; *Day* v. *Kansas City Pipe Line Co.,* 82 Kan. 861, 109 Pac. 186."

Mills v. *Hartz, supra,* was an action to cancel an oil and gas lease for a primary term of 20 years and as much longer as gas, coal and oil were found in paying quantities. Said lease contained no provision with reference to the commencement of a well on the leased premises. There was no development whatever upon said premises, and after a lapse of 7½ years the action was commenced to cancel said lease. There was no showing that it probably would not have been profitable to drill a well on said premises. The Court simply held in said case that where an oil and gas lease contains no provision with reference to the commencement of development there was an implied obligation to commence devel-

opment within a reasonable time after the execution of the lease and that the failure to commence development was a practical abandonment of the lease, There was no question in said case of the extent of the development required after oil or gas was discovered in paying quantities or of the right of the lessee to hold all of the leased premises after the discovery of oil and gas thereon where the circumstances indicated that oil or gas in paying quantities could not be produced from additional wells. It, therefore, follows that said case is not an authority one way or the other in the case at bar.

If the lessee in the foregoing case had drilled one or more wells on the leased premises within a reasonable time after the date of the execution of his lease, had discovered oil or gas in paying quantities therein, had continuously operated said well or wells, and suit had been brought to cancel the undeveloped portion of the lease for not having drilled an additional well or wells and it had been shown that it would probably not have been profitable to drill such additional well or wells, then said case would be in point with the case at bar. But no such situation—which is the situation involved in the case at bar—was involved in said case.

The gist of the Court's opinion in the foregoing case is to be found in this language: "Since the time for *commencing* the operation is not expressly stated, we must look to the terms of the lease and the subject of the contract to determine what was within the contemplation of the parties. We think the Court rightly held that, under such lease, it was the duty of the lessee to make a diligent search within a reasonable time." The lease in the case at bar,

unlike that in the foregoing case, expressly and specifically provides that the first well shall be commenced within one year, but that the commencement of said well might be deferred from year to year during the primary term of the lease by the payment of an annual rental of $1.00 per acre. And during the primary term of said lease the respondent or its predecessors in title drilled two wells upon the leased premises, discovered oil in paying quantities in each of said wells, and has continuously operated them and produced oil in paying quantities therefrom.

In the foregoing case the Court said: "When a lease provides how and when search for oil or gas shall be made, there is no room for implication. Likewise, if the parties provided for an option in the lessee to operate and pay a royalty on production, or to pay a stated rental if no development is made, the lessee may elect to delay and pay the stipulated price of such delay."

The original opinion in *Howerton* v. *Kansas Natural Gas Company, supra,* is reported in 81 Kan. 553, 106 Pac. 47, and discloses that the lease involved was executed on the 20th day of November, 1902, and was for a period of 10 years and as long thereafter as oil or gas was produced in paying quantities. Within one year after the execution of said lease a gas well was drilled on the leased premises capable of producing gas in commercial quantities sufficient to justify the expense of marketing the same. Nevertheless no sale of gas was made from said well and gas was not used therefrom in any way except that the lessee used some for fuel to furnish power for the drilling of two wells on adjacent premises leased from other owners. There was no further development or operation on said premises, and

on the 17th day of November, 1907, the lessor declared a forfeiture of the lease. Said lease provided that a well should be drilled thereon within one year and contained no provision for the payment of rentals for delay or failure to prosecute the work of development. There was no showing that gas could not be produced in paying quantities from additional wells, but the inference reasonably to be drawn from the opinion is that if additional wells had been drilled gas could have been produced therefrom in paying quantities. The lessee offered no excuse or justification whatever for its failure to market the gas from the well drilled or for its failure to further develop the premises. The Court in said case simply held that since the lessee was obligated to drill a well, it was further obligated to market the product of said well for the mutual benefit of the parties and that its failure to do so justified a forfeiture of the lease. While the opinion of the court states that the lessee was obligated to reasonably develop the premises, the court did not attempt to define "reasonable development", but it is clear that the court was of the impression that if additional wells had been drilled they would have produced in paying quantities. In the case at bar, as heretofore pointed out, the respondent was producing oil from the premises involved in paying quantities, and the uncontradicted evidence disclosed that oil could not have been found in paying quantities in any additional well or wells. Therefore, the aforesaid case is not an authority for the contention of petitioners.

The foregoing case was decided as though no well had been drilled by the lessee, the Court saying: "It is difficult to distinguish in principle between a case like that where a

default consists in failure to explore at all and a case like the present one, where a well has been drilled and the gas found, but no effort has been made to utilize or market it." If the gas well involved in the foregoing case had been operating—that is, if the gas had been continuously marketed therefrom, and the evidence had all been to the effect that it would probably not have paid to have drilled an additional well or wells and a suit had been brought to cancel the undeveloped portion of the lease, the case would be in point with the case at bar. However, no such state of facts was involved in said case.

The original opinion in the *Howerton* case, *supra*, was overruled on rehearing and the case reversed and remanded for further proceedings, as appears from the opinion in 82 Kan. 367, 107 Pac. 813, and we earnestly insist that the opinion on rehearing in said case is an authority for the contention of the respondent. On said rehearing, the Court held that the evidence did not disclose a right to have defendant's lease cancelled, but that the plaintiff was entitled to damages for the defendant's default. The Court said:

> "The default consisted in the failure to properly develop the leased territory by drilling and operating a reasonable number of wells necessary for that purpose, and the failure to market gas and make the payments, stipulated for the well completed. *No reason is shown why witnesses of experience acquainted with the gas field, may not testify with reasonable accuracy as to the number of wells which should have been drilled on the leased land both for protection from drainage by neighboring leaseholds and to obtain the gas underneath the land.* No insurmountable obstacle to such proof is perceived by the court, and, in the absence of evidence that it cannot be produced, it is concluded that the plaintiff

is not entitled to a remedy by forfeiture or cancellation of the lease. * * *

"It should be observed that this is not a case where royalties payable in a share of the product are provided for, but is an agreement to pay $50 per annum for each gas well. *The measure of damages therefore is the sum the plaintiff has lost or may lose by the failure of the defendant to complete the number of producing wells reasonably necessary to develop the resources of the leased land and to protect its lines.* * * *".

To the same effect was the specially concurring opinion of Justice PORTER, in which he said:

"I think the court should declare as a matter of law, from its knowledge of conditions in the oil and gas territory, *that witnesses of experience can testify with reasonable accuracy what number of wells would be required properly to develop the land embraced in the lease including such wells as would reasonably be necessary to protect the land from drainage from other wells*, and that since judicial knowledge takes the place of proof we should hold that the action to forfeit or cancel the lease cannot be maintained because it appears that the plaintiff has an adequate remedy in an action for damages."

Culbertson v. *Iola Portland Cement Co., supra*, was an action for an accounting from the defendant for gas obtained and used by it from the plaintiff's land through wells on his land and through wells drilled by defendant on adjoining land. It was alleged that there was a general pool of gas under plaintiff's land and that the defendant had drilled wells on adjoining premises and through them extracted gas from plaintiff's land. The evidence disclosed, and the referee to whom the case was referred found, that a large quantity of gas had been taken from said land, and the Court

held that plaintiff was entitled to an accounting therefor, whether it was obtained from wells drilled on his land or from those drilled on adjacent premises. In its opinion the Court said:

> "Since the number of wells to be drilled on the land was not specified, there was an implied obligation on appellants to fully develop the land and *put down as many wells as were necessary to secure to appellee his proportionate share of the pool of gas.*"

It clearly appears that the Court was not of the opinion that the defendant was obligated in all events to drill additional wells on the plaintiff's land, but was required only to drill such number of wells as were necessary to secure to the plaintiff his proportionate share of the pool of gas which the evidence disclosed underlaid his land and was being drained therefrom through wells on adjoining lands.

If it had been specifically shown by the defendant in the foregoing case, as was shown by the respondent in the case at bar, that it would probably not have paid to drill a well or wells upon the leased premises and that there had been and was no drainage through wells on adjoining premises, said case would be in point with the case at bar. But it appears that the very opposite was shown.

Day v. Kansas City Pipe Line Co., supra, was an action to cancel the undeveloped portion of a 600-acre lease by reason of the failure of the lessee to properly develop. Said lease required the lessee to drill 4 wells within 6 months and "*to continue drilling as long as paying wells were found or royalties were paid*". The original lessee drilled and completed 4 wells on 80 acres of said premises within the first 6 months after said lease was executed. No further de-

velopment was had for approximately 4 years, when the plaintiff filed his original petition. Subsequent to the filing of said petition, the lessee drilled 4 additional wells on another 80 acres of said lease, which produced oil in paying quantities, leaving the remainder of the 600 acres undeveloped. The trial court found that the lessee had not exercised reasonable diligence in developing the premises in accordance with the aforesaid provision of the lease and cancelled the lease as to all of the leased premises except the aforesaid 160 acres. There was no evidence that if additional wells had been drilled on the remainder of said premises oil or gas could not have been discovered therein in paying quantities, but the court simply held that *under the aforesaid clause of the lease requiring the lessee to continue drilling as long as paying wells were found or royalties were paid the lessee was expressly obligated to drill additional wells.* In its opinion the Court does not attempt to define "reasonable diligence" in any case, but says that "*what is due diligence is a question of fact* which has been decided adversely to the contention of appellant". Said case is, therefore, no authority that drilling and producing oil in paying quantities from the two wells involved in the case at bar was not due diligence, in view of the uncontradicted evidence that oil or gas could not have been produced in paying quantities from any additional well or wells on the premises involved. The statement by the court that if paying wells could not be found on the land, or any part of it, there was no reason why appellant's title should be longer clouded with a barren encumbrance or any reason why appellant should resist cancellation, was *obiter dictum,* and certainly not binding upon the federal court.

In the foregoing case the Court specifically said "it was not enough that 4 wells should be drilled within 6 months or any limited number on a part of the tract, but it was specifically required that drilling should continue with reasonable diligence *so long as paying wells could be found. The appellant was, of course, not required to develop land that had been tested and found to be unprofitable for operation* * * *."

It will thus be seen that none of the foregoing cases decided prior to the execution of the lease involved in the case at bar is contrary to respondent's contention. And *Brewster* v. *Lanyon Zinc Co., supra,* decided approximately 11 years before the execution of the lease involved herein, squarely supports such contention. Let us, therefore, proceed to analyze the cases decided subsequent to the execution of said lease.

The first case, *Alford* v. *Dennis, supra,* was an action to cancel an oil and gas lease in so far as it covered 220 acres of land belonging to the plaintiff. The original lease covered a tract containing some 936 acres, consisting of one tract of 716 acres and another tract some 2 miles distant therefrom, being the 220-acre tract in question. Subsequent to the execution of the lease the ownership of the two tracts was separated. Said lease was for a period of 10 years and as much longer as gas or oil was produced in paying quantities, and provided that the lessee should begin operations thereunder within 6 months from the delivery of the lease, and complete 3 wells on said premises, and that no other or additional expense should be incurred under said lease by the lessee. Twenty-five wells were drilled on the larger tract and the lessee paid royalties to the then

owners thereof, but never at any time during the 13 years between the execution of the lease and the commencement of the action did any drilling on the smaller tract. The petition disclosed that there had been three separate and distinct oil booms in the vicinity and that the plaintiff had had several opportunities to lease the aforesaid 220-acre tract, and prayed for a cancellation of the lease insofar as it covered said 220 acres. The lessee's demurrer to said petition was sustained by the trial court, from which ruling the lessor appealed. The opinion of the court recites that it was improvident for the owner to grant a lease on two large tracts for a long term without any requirements of exploration and development, but that it was not the province of the court to end a contract merely because it was a bad bargain. The court further stated that the petition narrated a predicament capable of some legal or equitable redress, not necessarily the redress prayed for by the plaintiff, and held that the case should be reversed and remanded to the trial court with directions to permit the issues to be joined and the facts determined and to allow plaintiff damages if they could be definitely ascertained, and in the alternative that the lessee be required to proceed in good faith to develop the premises within a reasonable time. Said opinion does not disclose that it was improbable that oil or gas could be produced on said premises in paying quantities. On the contrary, it is obvious that the court, under the allegations of the plaintiff's petition, was of the opinion that if further development was made oil or gas in paying quantities could be discovered. This conclusion is inevitable in view of the fact that the case of *Harris* v. *Ohio Oil Co.*, 48 N. E. 502, relied on by the Court in support of its decision

that the premises should be developed, held that the development required is such as is "usually found in the same business of an ordinary prudent man," and all that is required of the lessee is to drill such wells as are necessary for the production of the oil contained in the premises and afford ordinary protection to the lines. We are certainly not justified in assuming that there was any showing in the case that oil or gas in paying quantities could not be discovered, or that the court intended to require the defendant to perform apparently useless acts. The court did say that unless the plaintiff's tract was to be developed some time there was no reason to include it in the lease and that if the defendant had no bona fide intention to develop said tract to cancel the lease would do him no injury, but, as heretofore pointed out, the court refused to cancel said lease and said statemen was *obiter dictum.* Said case is certainly no authority for the proposition that where there are producing wells on a lease and the evidence discloses that oil or gas probably would not be discovered in paying quantities on the remainder of the lease, the lessor is entitled to a cancellation as to the undeveloped portion of the lease.

The foregoing case seems to have been decided upon the theory that since the lease involved did not specify the time for the commencement of a well upon the 220-acre tract, which was not contiguous to the other 716 acres covered by said lease, the law implied an obligation to commence a well thereon within a reasonable time from the date of the lease.

If all the land covered by the lease in the foregoing case had been contiguous and producing wells had been

drilled thereon and continuously operated, and it had been shown that it would have probably been unprofitable to drill an additional well or wells, and a suit had been brought to cancel the undeveloped portion of the lease, the case would be in point with the case at bar. And in this connection it is to be noted that in said case the plaintiff did not seek to cancel the undeveloped portion of the 716-acre tract on which producing wells had been drilled.

Webb v. *Croft, supra,* was an action to cancel an oil and gas lease on several tracts of land, comprising 580 acres. The lease was for a term of 5 years and as long thereafter as oil or gas, or either of them, was produced therefrom. Said lease further provided that the lessee should complete a well within 12 months from the date of the lease or pay to the lessor $580.00 per year for each year drilling was delayed. There was no development until shortly prior to the expiration of the primary term of the lease, but a producing gas well was completed one day before the expiration of the lease. The trial court found that the lease had not been sufficiently developed and decreed that there should be further development and provided in said decree what further development should be made and the time within which it should be made. From said decree the defendant appealed. The only justification offered by the defendant for its failure to drill any other or additional wells on the premises was that there was no market for more gas in the vicinity than was already being produced. There was no showing that oil or gas could not have been discovered in paying quantities had additional wells been drilled. Relying on and citing with approval *Howerton* v. *Kansas Nat-*

ural Gas Company, supra, and *Alford* v. *Dennis, supra,* the Court said:

> "The lease is silent as to the number of wells that shall be drilled on the land, and in such a case there is an implication that there shall be reasonable development of the land *by drilling such number of wells as an ordinary prudent man would do under the circumstances, taking into consideration the results of the development and whether or not there was sufficient production to warrant the continuance of exploration and drilling.*"

Therefore, the foregoing case, rather than being an authority for the contention of the petitioners, is a direct authority for the contention of the respondent.

Clearly the Court ordered development under the justified assumption that oil or gas could be produced in paying quantities from additional wells.

In the foregoing case the Court said:

> "Two producing oil wells have been drilled by others on land in the vicinity of that in question, and there is some reason to infer that through exploration oil might be found on the land of plaintiff. *Gas has been found there, and yet defendants have failed for four years to drill another well near the producing one, and their excuse is that there is no market in that locality for more gas than is already being produced and no more than is necessary to supply the City of Moline.* * * *"

McCarney v. *Freel, supra,* is the only Kansas case cited by the petitioners which is in the least contrary to the contention of the respondent. That case was an action to cancel an oil and gas mining lease which covered a quarter section of land, which said lease was for a term of 10 years

and as much longer as oil or gas could be produced in paying quantities. Four months after the execution of the lease a well was drilled, which produced oil in paying quantities, and continued to so produce until the time of the trial of said case. Five years thereafter a dry hole was drilled on said premises, and no further effort was made to develop the resources of the land. The trial court cancelled said lease, and, in affirming the action of the trial court, the Supreme Court said that the "plaintiff's evidence warranted the inference that defendants have not reasonably developed her land." Upon that theory alone the plaintiff was entitled to a cancellation of the lease on the undeveloped portion of the leased premises. The Court, however, went on to say:

> "If the undeveloped portion of the land will not produce mineral in paying quantities, and the lessee would not be justified in drilling more wells, he may not continue to hold by virtue of a provision in the lease extending the term so long as oil or gas may be produced in paying quantities."

The opinion in said case covers less than a half page of the Pacific Reporter, and the Court does not cite a single case in support of its conclusion. Said case is contrary to the decision of the same Court in *Webb* v. *Croft, supra,* decided a few months prior to said case. We, therefore, earnestly insist that little or no weight should be attached to said case, and that since said case was decided long subsequent to the execution of the lease in the case at bar and is contrary to the former decisions of the same Court, the decision in said case is not binding upon the federal court as establishing a rule of property.

Summarizing, none of the foregoing cases, with the exception of the *dictum* in *McCarney* v. *Freel, supra,* is authority for the petitioners' contention that there is an implied covenant in an oil and gas mining lease to further develop the premises under lease where the evidence discloses that oil or gas is being produced therefrom in paying quantities and further discloses that oil or gas could not be produced in paying quantities in any additional well or wells on said premises, and that no reasonably prudent operator would drill an additional well. On the contrary, said cases clearly establish that under a lease such as is involved in the case at bar the lessee is obligated to drill only such wells as a reasonably prudent operator would, under the circumstances, drill. It, therefore, follows that the decision of the Circuit Court of Appeals herein is not contrary to the Kansas decisions.

It is very significant that in most of the foregoing Kansas cases the Court considered the developments upon lands in the vicinity of those involved, but we submit that, if, as is contended by petitioners, a producing oil and gas lease in Kansas may be cancelled as to the undeveloped portion thereof upon the sole ground of no additional drilling during a long lapse of time, then, the developments upon surrounding lands and the prospect of discovery of oil or gas in paying quantities in additional wells are wholly immaterial.

The Kansas cases require the plaintiff in an action to cancel an oil and gas lease for breach of an implied obligation to develop or further develop to show as a prerequisite to the right of cancellation that plaintiff's damages are not susceptible of measurement, and no such showing was made in the case at bar.

In the case of *Howerton* v. *Kansas Natural Gas Co.*, 81 Kan. 553, 108 Pac. 813, it was specifically held that in an action to cancel an oil and gas lease for failure to fully develop the leased premises the burden was upon the plaintiff to show that a remedy in damages was not an adequate remedy and in the absence of such showing a decree for cancellation would not be sustained. In the case at bar no such showing was made or even attempted.

The respondent has never abandoned the premises involved herein, or any part thereof.

We have heretofore called the court's attention to the fact that there is no allegation in the petitioners' bill to the effect that the respondent had ever abandoned the premises covered by its lease, or any part thereof. Furthermore, there was no proof of abandonment and the trial court made no finding that there was any abandonment. The only evidence on the subject was that of the respondent, whose vice-president, Mr. G. O. Moody, testified that the respondent had never abandoned or intended to abandon any part of the premises covered by its lease, and that it was, and had at all times been, ready, willing and able to further develop said premises when the circumstances justified the same.

In the case of *Blackwell Oil & Gas Company, et. al.*, v. *Whited*, 81 Okl. 45, 196 Pac. 688, the Supreme Court of

Oklahoma states the general rule with reference to the abandonment of an oil and gas lease in the following language:

> "To constitute 'abandonment' in respect of property, there must be a concurrence of the intention to abandon, and an actual relinquishment of the property, so that it may be appropriated by the next comer. In determining whether one has abandoned his property rights, the intention is the first and paramount object of inquiry; for there can be no abandonment without the intention to abandon."

To the same effect is the case of *United States* v. *Brown, et al.*, 15 F. (2d) 565, in which Judge KENNAMER said: "To constitute abandonment there must be a coincidence of act and intention and the evidence adduced does not establish a definite intention to abandon."

The petitioners were not entitled to maintain the case at bar for the reason that they neither alleged nor proved that prior to the commencement of the same they properly notified the respondent to drill the additional wells which they claim it was obligated to drill.

The petitioners alleged in their bill that on the 10th day of June, 1926, the following letter was written by Phillip Sauder, the lessor in the lease involved herein, to the Mid-Continent Petroleum Corporation, respondent herein, which letter is attached to their bill, marked "Exhibit B", and reads as follows:

> "I hereby wish to remind you that the time on your lease dated June 6, 1916, on my farm has expired. The lease being for ten years or as long thereafter as oil

or gas can be found in paying quantities. Now this puts it on a paying basis. Either it pays or it don't.

"That is for you to say. If it pays I understand you are supposed *to operate* and if it does not pay I understand the lease is *run out* and I hereby ask you to release it, except that portion which you have operated on and are producing a little oil.

"Please let me know what you will do. I believe I am entitled to some action."

The foregoing letter is the only evidence of notice to or demand upon the respondent herein to further develop the premises involved herein. The respondent admitted that it received the aforesaid letter.

It is thoroughly established by the authorities that a suit to cancel an oil and gas lease for failure to drill "offset" wells or to further develop the leased premises after oil or gas in paying quantities has been discovered thereon, cannot be maintained until the lessor has given the lessee unequivocal and unconditional notice of his intention to declare a forfeiture of the lease if it is not fully developed, and a reasonable time must be given in said notice for future development. However, the most that can be said of the above quoted letter is that it demanded a release of the lease herein involved if said lease was not then producing oil in paying quantities. Said letter certainly was not an unequivocal demand for future development or notice of intention of the lessor to forfeit respondent's lease if it was not further developed.

In the case of *Leeper Oil Company* v. *Rowland*, 39 S. W. (2d) (Ky.) 486, the Court held:

"Giving of unequivocal notice of unconditional de-

mand *to develop* is condition precedent to enforcement of right to forfeit oil lease under doctrine of implied covenant."

See to same effect:

Lawrence Oil Corp. v. *Metcalfe*, 43 S. W. (2d) (Ky.) 986;

Young, et al., v. *Rainey, et al.*, 86 Kan. 296, 119 Pac. 873;

Leeper, et al., v. *Lemon G. Neely Co.*, 193 Fed. (6 C. C. A.) 967;

Wapa Oil and Development Co. v. *McBride*, 84 Okl. 184, 201 Pac. 984;

Papoose Oil Co. v. *Rainey, et al.*, 89 Okl. 110, 213 Pac. 882;

Farmers Mutual Oil Leasing Co., et al., v. *Bonneau*, 110 Okl. 168, 237 Pac. 83.

Applying the foregoing authorities to the case at bar, it is our contention that the aforesaid letter of June 10, 1926, was entirely insufficient to comply with the requirement of an unequivocal notice to the respondent for further development of the premises involved herein.

Contrary to petitioners' contention, an oil and gas lease in Kansas does not convey an interest in real estate.

We are astonished at the assertion of petitioners, in their petition herein for a writ of *certiorari*, that in Kansas "an oil and gas lease conveys an interest in real estate". In said statement they cite *Robinson* v. *Smalley*, 102 Kan. 842, 171 Pac. 1155; *Huston* v. *Cox*, 103 Kan. 73, 172 Pac. 992; and *Brinkman* v. *Empire Gas & Fuel Co.*, 120 Kan. 602, 245 Pac. 107. Instead of these cases supporting the statement of petitioners, they hold the very opposite.

Judge McDermott, in his dissenting opinion herein, likewise erroneously asserts that "an oil and gas lease in Kansas conveys an interest in real estate", citing *Robinson* v. *Smalley, supra.*

In *Robinson* v. *Smalley, supra,* the Court said:

> "While the court has held that an oil and gas lease of the kind under consideration does not constitute a conveyance, will not support a mechanic's lien, does not operate as a grant and severance of mineral in place, *and creates no estate proper in the land itself,* it does create an incorporeal hereditament. A contract for the sale of hereditaments, whether incorporeal or corporeal, is within the sixth section of the statute of frauds. Gen. Stat. 1915, Sec. 4889."

In *Huston* v. *Cox, supra,* the Court held:

> "A lease granting the right to enter on land and to explore for oil and gas, and if it be found in paying quantities, to operate and produce, is not a lease in the strict sense, and creates no estate in the lands, but merely an 'incorporeal hereditament,' which is a right growing out of, or concerning, or annexed to, a corporeal thing, but not the substance of the thing itself."

In the course of the opinion in said case the Court said:

> "In this instance the right granted was exclusive to the grantees, and it is said this fact changed the nature of the grant. The circumstance that the grantors precluded themselves from making other leases does not change the thing the grantees acquired from one of an incorporeal to one of a corporeal nature."

In *Brinkman* v. *Empire Gas & Fuel Co., supra,* which involved a producing oil and gas lease, the Court said:

> "The result of the foregoing is, *there was a contract.* Walker was granted exclusive privilege for 10

years to enter upon, operate for, and procure oil and gas on the Shriver farm. *The nature of the grant is well understood. It was a grant of a profit á prendre.* The grantee might utilize or refrain from utilizing his purchased privilege, subject to the conditions of the grant."

In *Mills* v. *Hartz,* 77 Kan. 218, 94 Pac. 142, the Court said:

"*The lease is not a grant of land, nor of the oil, coal, or gas in the land.* It did not transfer any estate to Mills, and hence some of the rules which he invokes as to nonuser and abandonment do not apply. *Hartz granted him the possession of a part of the land with the right to search for minerals, and gave him an interest in so much of the minerals as might be found and taken out, but, if none were found, no interest in the undiscovered mineral could be acquired by him, and certainly no estate in the land.*"

In *Kansas Natural Gas Co.* v. *Board of Com'rs of Neosho County, et al.,* 75 Kan. 335, 89 Pac. 750, the Court said:

"Such being the scope and purpose of the law, the lease in question brought into existence no state of facts to which it might apply. The lease grants no estate in the land or in the oil or gas which it may contain. It creates an incorporeal hereditament only, a license to enter and explore for oil and gas, and if they are discovered to produce and sever them. *Rawlings* v. *Armel,* 70 Kan. 778, 79 Pac. 683; *Dickey* v. *Brick Co.,* 69 Kan. 106, 76 Pac. 398. Until discovered and brought to the surface, no severance of title occurs. The minerals not only remain a constituent part of the land, but they belong to the owner of the surface soil beneath which they lie. The lessee has no 'right or title' to them (see *Zinc Co.* v. *Freeman,* 68 Kan. 691, 75 Pac. 995), and they are not separately taxable to him."

In *Phillips* v. *Springfield Crude Oil Co., et al.*, 76 Kan. 783, 92 Pac. 1119, and *Martin* v. *Springfield Crude Oil Co., et al.*, 77 Kan. 851, 92 Pac. 1119, it was held "that a mechanic's lien will not attach to the interest acquired in lands by the lessee under an ordinary oil and gas lease, *notwithstanding oil or gas is discovered.*"

In the chapter in Summers on Oil & Gas (published 1927) dealing with the nature of a lessee's interest under an oil and gas lease, page 187, the author, citing numerous Kansas cases in support thereof, says:

> "In Kansas the court of that state has held, apparently without any regard to the type of the granting clause, that an oil and gas lease creates a license, incorporeal hereditament, or *profit á prendre*. There is practically no explanation in the cases as to the sense in which the above terms are used, or the reasons for the court's view as to the incorporeal nature of the interest created. The statement found in *Funk* v. *Haldeman*, to the effect that the lessee acquired no estate in the land, or in the oil and gas, by virtue of an oil and gas lease, occurs in substance in several Kansas cases. It has been held that an oil and gas lease does not create a leasehold, or any estate in land, as distinguished from a license, within the meaning of the mechanic's lien statute. But it is held that the interest created is of such a character that it is an alienation within the meaning of the homestead statute, and must be in writing under the statute of frauds. Perhaps the most litigation in Kansas involving the nature of the interest created by oil and gas leases has been in connection with the matter of taxation. A statute provided that, where 'the right or title to any minerals' in land were in one person and the fee to the surface of the same land in another person, the 'right to such minerals' be separately taxed. Under this statute the Kansas

court in several cases held, without regard to the nature of the granting clause, that leases did not create separate estates in the land, or in oil and gas, subject to taxation. The question has never been tested by ejectment, but in a case where a co-lessee brought an action of ejectment and partition the court remarked that the action of ejectment was not taken seriously by either of the parties, and the partition suit could not be maintained, because the interest created was not real estate."

Since filing their petition for writ of *certiorari,* the petitioners seem to have undergone a change of mind with reference to the nature of an oil and gas lease in Kansas, for in their brief they now say: "* * * an oil and gas lease may not convey what is technically described as an estate in land." It seems now to be their position that under the Kansas law such an instrument merely grants rights in connection with property having a "definite and fixed location", to-wit: land.

An examination of the authorities cited in petitioners' brief relative to the instant contention will, we think, disclose that none of them conflicts with what we have hereinbefore said with respect to the nature of an oil and gas lease under the Kansas decisions. On the contrary, there is much in said citations which very definitely supports our contention.

Inasmuch as the nature of the interest of an oil and gas lessee in Illinois is decidedly different from what it is in Kansas, the case of *Guffey* v. *Smith,* 237 U. S. 101, 59 L. ed. 856, is distinguishable from the case at bar. In that case Mr. Justice VAN DEVANTER said:

"It is settled by the decisions of the Supreme

Court of Illinois that an oil and gas lease like that of the complainants passes to the lessee, his heirs and assigns, a present vested right—'a freehold interest'—in the premises, that this interest is taxable as real property, and that the clause giving the lessee an option to surrender the lease at any time is valid, does not create a tenancy at will or give the lessor an option to compel a surrender, and does not make the lease void as wanting in mutuality. *Bruner* v. *Hicks,* 230 Ill. 536, 540, 542, 120 Am. St. Rep. 332, 82 N. E. 888; *Watford Oil & Gas Co.* v. *Shipman,* 233 Ill. 9, 13, 14, 122 Am. St. Rep. 144, 84 N. E. 53; *Poe* v. *Ulrey,* 233 Ill. 56, 62, 64, 84 N. E. 46; *Ulrey* v. *Keith,* 237 Ill. 284, 298, 86 N. E. 696; *People, ex rel. Carrell,* v. *Bell,* 237 Ill. 332, 339, 19 L. R. A. (n.s.) 746, 86 N. E. 593, 15 Ann. Cas. 511; *Daugherty* v. *Ohio Oil Co.,* 263 Ill. 518, 524, 105 N. E. 308. These decisions constitute rules of property and must be accepted and applied in passing upon the complainants' rights."

Guffey v. *Smith* is further distinguishable from the case at bar in that its purpose was to prevent the owner of an interest in real property from being deprived thereof by a trespasser, whereas the case at bar only involves the question as to whether respondent has breached an implied obligation of a contract.

Since none of the foregoing Kansas cases involved the precise facts involved in the case at bar, the Circuit Court of Appeals was not bound thereby.

As heretofore pointed out, in not a single one of the Kansas cases relied on by the petitioners did the evidence disclose that if additional wells had been drilled on the premises involved therein said wells would not have produced oil or gas in paying quantities, or that a reasonably

prudent operator would not have drilled an additional well or wells thereon. Moreover, it does not appear that the defendant in any of said cases resisted the plaintiff's action to cancel his lease or the undeveloped portion thereof upon the ground that it would have in all probability been unprofitable to have drilled an additional well or wells upon the leased premises. Consequently, none of said cases presented the precise facts involved in the case at bar.

In *John Deere Plow Co.* v. *Mowry,* (6 C. C. A.) 222 Fed. 1, the Court held:

> "'It is only to a settled rule of a state court applicable to the precise facts disclosed by the record that a federal court should yield its own judgment.'"

Since the lease involved herein was executed and the rights of the respondent accrued thereunder prior to the only Kansas case, to-wit, *McCarney v. Freel, supra,* which can be said to conflict with respondent's contention, the Circuit Court of Appeals was not required to follow said case.

The case of *McCarney* v. *Freel, supra,* was decided June 12, 1926, and the lease involved herein was executed on the 6th day of June, 1916.

In 25 Corpus Juris, at page 843, section 179, the following general rule is stated:

> "When contracts and transactions have been entered into and rights have accrued thereon under a particular state of decisions, or when there has been no decision of the state tribunals, the federal courts will adopt their own interpretation of the law applicable to the case, although a different interpretation may be adopted by the state courts after such rights have accrued. * * *"

In the case of *Barton V. Kuhn* v. *Fairmont Coal Company,* 215 U. S. 348, 54 L. ed. 229, this Court held as follows:

> "A decision of the highest state court that the grantor in a deed conveying the coal under a tract of land, with the right to excavate, and remove all of the coal, cannot maintain an action for damages in tort, founded upon the failure of the grantee or his successors to leave sufficient support to the overlying or surface land, is not binding upon the federal courts in a similar action based on almost identical facts and circumstances, the granting clause of the two deeds being in fact identical, where such decision was handed down after the deed upon which the defendant relies was executed, and after the injury complained of was sustained, and the action begun, and where the point decided had not been previously adjudged by the state Supreme Court."

In the case of *Denker* v. *Mid-Continent Petroleum Corporation,* 56 F. (2d) 725 (10 C. C. A.), deciding the identical question involved herein, it was held:

> "Decisions construing oil leases decided after lease involved was executed, *held* persuasive only."

In *Mothersead, State Bank Com'r of Oklahoma,* v. *United States Fidelity & Guaranty Co.,* 22 F. (2d) 644 (8 C. C. A.), it was held:

> "Decision rendered by the highest state court after rights and liabilities of parties under contracts involved in federal court suit have fully accrued is not binding on federal courts as a rule of decision."

In *Butte & Superior Copper Co.* v. *Clark-Montana Realty Co., et al.,* (9 C. C. A.) 248 Fed. 609, affirmed 249 U. S. 12, 63 L. ed. 447, the Court said:

"Decisions of the Montana state court as to the validity of mining locations are not precedents binding on the federal courts in a suit involving the validity of locations in that state made prior to the rendition of such decisions of the Montana court."

The matter of construing an oil and gas lease is a matter of general law concerning which the federal courts will reach their own conclusion.

Oil and gas leases such as the one involved herein are by no means peculiar to the State of Kansas. On the contrary, substantially the same form of lease is and has been for many years in general use in all of the oil producing states of the Union. Consequently, uniformity as to the construction of the obligations of a lessee under such a lease is of great importance to the oil industry. And it would seem that the mere matter of construing and defining either the express or the implied covenants of such an instrument is a matter of general law, as much so as the matter of construing and defining either the express or implied covenants of any other contract of general use throughout the United States. The fact that the contract happens to relate to property having a fixed and definite situs should make no difference, particularly in view of the Kansas decisions with respect to the nature of an oil and gas lease.

A question quite similar to the one involved in the case at bar was before this Court in the case of *Black & White T. & T. Co.* v. *Brown & Yellow T. & T. Co.*, 277 U. S. 518, 72 L. ed. 681. There a railroad company by a written instrument or contract granted to a transfer company certain exclusive privileges at its station in Bowling

Green, Kentucky, and the question was whether same was against public policy. The contract related solely and exclusively to property having a fixed and definite situs in the State of Kentucky, and the term thereof was fixed at one year, to continue for consecutive yearly periods until terminated by either party on 30 days' notice. The complaint alleged that the railroad company had failed to carry out the contract, in that it allowed others to enter upon the property involved and to exercise the privileges granted exclusively to the transfer company. The courts of Kentucky had held such contracts invalid, but this Court held it was not bound by such decisions. In the opinion by Mr. Justice BUTLER, it was said:

> "The contract gives respondent, subject to termination on short notice, license or privilege to solicit patronage and park its vehicles on railroad property at train time. There is no question concerning title to the land. * * * As respects the rule of decision to be followed by federal courts, distinction has always been made between statutes of a state and the decisions of its courts on questions of general law. The applicable rule sustained by many decisions of this court is that in determining questions of general law, the federal courts, while inclining to follow the decisions of the courts of the state in which the controversy arises, are free to exercise their own independent judgment. That this case depends on such a question is clearly shown by many decisions of this court."

In *Swift* v. *Tyson*, 41 U. S. 1, 10 L. ed. 865, Mr. Justice STORY, in referring to the thirty-fourth section of the Judiciary Act of 1789, said:

> "It never has been supposed by us, that the section did not apply, or was designed to apply, to ques-

tions of a more general nature, not at all dependent upon local statutes or local usages of a fixed and permanent operation, as, for example, *to the construction of ordinary contracts or other written instruments,* and especially to questions of general commercial law, where the state tribunals are called upon to perform the like functions as ourselves, that is, *to ascertain upon general reasoning and legal analogies, what is the true exposition of the contract or instrument,* or what is the just rule furnished by the principles of commercial law to govern the case."

In *Kuhn* v. *Fairmont Coal Co.*, 215 U. S. 348, 54 L. ed. 229, the Court said:

"'In *Foxcroft* v. *Mallett*, 4 Hod. 353, 379, 11 L. ed. 1008, 1019, the object of the action was to recover certain land in Maine. The case turned in part on the construction to be given to a mortgage of certain land to Williams College, and to local adjudications relating to those lands, which, it was contended, were conclusive on the parties. 'But,' this court said, 'on examining the particulars of the cases cited to govern this (*Williams College* v. *Mallett*, 12 Me. 398; *Williams College* v. *Mallett*, 16 Me. 84; *Randell* v. *Mallett*, 14 Me. 51), it will be seen that the construction of the mortgage to the college, in respect to this reservation or condition, never appears to have been agitated. *If it had been,* the decision would be entitled to high respect, though it should not be regarded as conclusive *on the mere construction of a deed as to matters and language belonging to the common law, and not to any local statute. Williams* v. *Suffolk Ins. Co.*, 3 Sumn. 270, 277, Fed Cas. No. 17738.'

"In *Russell* v. *Southard*, 12 How. 139, 147, 14 L. ed. 927, 930, the controlling question was whether, in any case, it was admissible to show by extraneous evidence that a deed on its face of certain real estate in Kentucky was really intended by the parties as a security for a loan and as a mortgage. The court, speak-

ing by Mr. Justice CURTIS, after citing adjudged cases sustaining the proposition that evidence of that kind was admissible in certain states, said: 'It is suggested that a different rule is held by the highest court of equity in Kentucky. If it were, with great respect for that learned court, this court would not feel bound thereby. This being a suit in equity, and oral evidence being admitted or rejected, not by the mere force of any state statute, but upon the principles of general equity jurisprudence, this court must be governed by its own views of those principles'—citing *Robinson* v. *Campbell*, 3 Wheat. 212, 4 L. ed. 372; *United States* v. *Howland*, 4 Wheat. 108, 4 L. ed. 526; *Boyle* v. *Zacharie*, 6 Pet. 658, 8 L. ed. 536; *Swift* v. *Tyson*, 16 Pet. 1, 10 L. ed. 865; *Foxcroft* v. *Mallett*, 4 How. 379, 11 L. ed. 1019.

"In *Yates* v. *Milwaukee*, 10 Wall. 497, 506, 19 L. ed. 984, 987, the question was as to the nature and extent of the right of an owner of land in Wisconsin, bordering on a public navigable water, to make a landing, wharf, or pier for his own use or for the use of the public. There was a question in the case of dedication to public use, and the City of Milwaukee sought to change or remove the wharf erected by the riparian owner in front of his lot. This court, speaking by Mr. Justice MILLER, said: 'This question of dedication on which the whole of that case turned, was one of fact, to be determined by ascertaining the intention of those who laid out the lots, from what they did, and from the application of general common-law principles to their acts. This does not depend upon state statute or local state law. The law which governs the case is the common law, on which this court has never acknowledged the right of the state courts to control our decisions, except, perhaps, in a class of cases where the state courts have established, by *repeated decisions, a rule of property* in regard to land titles peculiar to the state.'

"In *Louisville Trust Co.* v. *Cincinnati*, 22 C. C. A. 334, 338, 341, 47 U. S. App. 36, 45, 51, 76 Fed. 296, 300,

304, which was a suit by a Kentucky corporation, it became necessary to determine the force and effect of a mortgage originating in a state statute of Ohio and certain municipal ordinances covering street easements in Cincinnati. The state court, in a suit to which the trustee in the mortgage was not a party, passed a decree declaring the scope, effect, and duration of contracts or ordinances under which the mortgage, easements and franchises originated. It was insisted that the federal court was bound to accept the views of the state court. But the Circuit Court of Appeals, held by Judges TAFT, LURTON and HAMMOND, ruled otherwise. Judge LURTON, speaking for all members of that court, made an extended review of the authorities, and observed that if the state decision was regarded as conclusive upon the parties, 'the constitutional right of the complainant, as a citizen of a state other than Ohio, to have its rights as a mortgagee defined and adjudged by a court of the United States, is of no real value. If this court cannot for itself examine these street contracts and determine their validity, effect and duration, and must follow the interpretation and construction placed on them by another court in a suit begun *after its rights as mortgagee had accrued, and to which it was not a party,* then the right of such a mortgagee to have a hearing before judgment and a trial before execution is a matter of form without substance. The better forum for a suitor so situated would be a court of the state. * * * The validity, effect and duration of the street easements, granted or claimed under these laws and ordinances is a question which this complainant is entitled to have decided by the courts of the United States, and the opinion of the Supreme Court of Ohio, while entitled to the highest respect as a tribunal of exalted ability, can be given no greater weight or respect than its reasoning shall demand, where the contract rights of a citizen of another state are involved, who was neither a party nor privy to the suit in which that opinion was delivered. The special fact,

therefore, which justifies us in determining for ourselves the true meaning and validity of the Ohio statutes and city ordinances out of which the rights of this complainant spring is the fact that it is a citizen of another state, and that the contract under which it has acquired an interest originated prior to the judicial opinion relied upon as foreclosing our judgment'."

In *Midland Valley R. Co.* v. *Jarvis*, 29 F. (2d) (8 C. C. A.) 539, a proceeding by the railroad company to enjoin a lessee of land subject to the railroad's right-of-way from erecting any structures, drilling for oil on the premises or using them for anything which would interfere with the railroad in its present or future use of its right-of-way, the Court held that *the extent of the use and enjoyment possessed by the railroad company in its right-of-way is a question of general law*, which is not controlled in federal courts by the decisions of the courts of the state in which the right-of-way is located.

The same state of facts was involved and the same conclusion was reached in *Midland Valley Railroad Co.* v. *Sutter*, 28 F. (2d) (8 C. C. A.) 163, and in 280 U. S. 521, 74 L. ed. 590, this Court dismissed the writ of *certiorari* therein.

Since the relief sought herein is wholly in equity, the Circuit Court of Appeals was not bound by any Kansas decisions.

The sole question in the case at bar is whether or not the petitioners are entitled to a cancellation of respondent's lease by reason of the alleged breach of the implied covenant thereof to reasonably develop the leased premises. There is no question of the validity of the oil and gas lease,

or of the title to or interest in land acquired by the lessee thereunder, involved herein. And the question whether or not there has been such a breach of either the express or the implied covenants of an oil and gas lease as to entitle the lessor to a cancellation thereof is purely an equitable question, depending for its decision upon the general principles of equity jurisprudence, and it is well established that federal courts are not bound to follow decisions of state courts on such questions.

Section 34 of the Judiciary Act of 1789 (now Rev. Stat., Sec. 721, U. S. C. A., Title 28, Sec. 725), relates exclusively to "trials at common law."

In *Bucher* v. *Cheshire Railroad Co.*, 125 U. S. 555, 31 L. ed. 795, the Court said:

> "The language of the statute limits its application to cases of trials at common law. There is, therefore, nothing in the section which requires it to be applied to proceedings in equity, or in admiralty; nor is it applicable to criminal offenses against the United States —see *U. S.* v. *Reid*, 53 U. S. 2 How. 361 (13:1023)—or where the Constitution, treaties or statutes of the United States require other rules of decision."

In *Brill* v. *W. B. Foshay Co., et al.*, 65 F. (2d) (8 C. C. A.) 420, the Court held:

> "State laws do not constitute rule of decision in federal equity courts."

In said case the complainant, receiver for Foshay Investors' Corporation, a Minnesota corporation, brought suit against the receiver of W. B. Foshay Company, a Delaware corporation, to impress a lien upon the assets of said Delaware corporation in favor of creditors of the Min-

nesota corporation. The Delaware corporation was organized for the sole purpose of taking over the assets and conducting the business of the Minnesota corporation. At the time of the conveyance of the assets of the Minnesota corporation to the Delaware corporation, the liabilities of the Minnesota corporation exceeded the assets thereof. The contention of the complainant was that under the Minnesota statutes, the conveyance by the Minnesota corporation to the Delaware corporation was fraudulent and void as to creditors, and that the creditors of the Minnesota corporation had a prior claim to the assets of the Delaware corporation over the creditors of the Delaware corporation. In the body of the opinion the Court said:

> "It is, however, urged that the Minnesota statute contains no exceptions, and hence, based upon the letter of the statute, regardless of the equities involved, plaintiff is entitled to have the transfer set aside and the property devoted to the payment of the debts of the Minnesota company in preference to or exclusion of the creditors of the Delaware company. To so hold would be so inequitable and harsh as to shock the conscience of the chancellor, and we cannot accede to this contention. Equity will not lend its aid to one whose sole ground for seeking such aid is based upon a technicality. Only a part of the property transferred had a situs in the State of Minnesota. *State laws do not constitute a rule of decision in federal courts of equity.* The equitable jurisdiction of federal courts is that which was exercised by the High Court of Chancery in England at the time of the adoption of the Constitution, and the passage of the original Judiciary Act, unless subsequently changed or enlarged by Act of Congress. This jurisdiction is administered uniformly throughout all the states, and furnishes one and the same rule of decision for federal courts of equity, and

state laws do not ordinarily constitute a rule of decision binding on federal courts of equity. *Hollins* v. *Brierfield Coal, etc., Co.*, 150 U. S. 371, 14 S. Ct. 127, 37 L. ed. 1113; *Pusey & Jones Co.* v. *Hanssen*, 261 U. S. 491, 43 S. Ct. 454, 67 L. ed. 763; *Cates* v. *Allen*, 149 U. S. 451, 13 S. Ct. 883, 37 L. ed. 804; *Scott* v. *Neely*, 140 U. S. 106, 11 S. Ct. 712, 35 L. ed. 358; *Smith* v. *Ft. Scott, etc., R. Co.*, 99 U. S. 398, 25 L. ed. 437; *Neves* v. *Scott*, 13 How. 268, 14 L. ed. 140; *Harrison* v. *Farmers' L. & T. Co.*, (C. C. A. 5) 94 F. 728; *Hall* v. *Gambrill*, (C. C. A. 4) 92 F. 32. Where the application of a state statute to the facts of a case will violate the fundamental principles of equity, a federal court of equity should not enforce the letter of such a statute."

In the case of *Lyon, et al.*, v. *Union Gas & Oil Co., et al.*, 274 Fed. 957, the United States District Court for the Eastern District of Kentucky held:

"The decision of the state court that equity would enforce the forfeiture of an oil and gas lease for failure to develop after reasonable notice is one affecting the right to relief in equity, which is not binding on the federal court, especially where the decision was a *dictum*, and a statute had since been enacted establishing the contrary rule."

During the course of the opinion in said case, Judge COCHRAN said:

"It seems to me that, if that doctrine is to prevail, it is decidedly questionable whether the notice given here was a reasonable one, only 3 months, and the lease contemplated an annual rental payment. It may be that, if that doctrine applies, there ought to be a year's notice. At any rate, the burden was on the plaintiff to show that that was a reasonable time, and it is extremely doubtful, to say the least of it, whether or not they made out that a reasonable time had elapsed. However

that may be, I do not think that I am controlled by the decision of the Kentucky Court of Appeals in the *Monarch* case. The Kentucky Court of Appeals has never actually applied that doctrine to a single solitary case. Never has a lease been forfeited by that court upon a notice requiring development. The statement of the Court of Appeals that a forfeiture can be brought about in this way is pure *dictum*. As stated, never yet has a case been decided by them where a lease has been declared forfeited upon a notice.

"Furthermore, I do not think that *dictum* is sound. According to the very terms of the lease, delay in development is authorized on the payment of the rental. For a court to forfeit a lease on failure to develop on notice is to change the contract of the parties. If the legislature were to pass a law saying or providing that in a lease of this character development might be hastened by giving notice, it would be in violation of the constitutional provision that inhibits the legislature passing a law impairing the obligation of a contract. Then, in March, 1920, the legislature passed an act overthrowing that doctrine, saying that no lease could be forfeited in that way. So it is no longer a doctrine in Kentucky that a lease can be forfeited in that way. But I do not think that, if that statute had never been passed, I would be bound to follow that *dictum* of the Court of Appeals. All that is involved is a question of equitable relief. The Supreme Court of Illinois had held that it was not equitble to enforce a lease if it had a surrender clause in it, and yet the Supreme Court of the United States, in the case of *Guffey* v. *Smith*, 237 U. S. 101, 35 Sup. Ct. 526, 59 L. ed. 856, decided that the federal court was not bound by that decision—that the federal court would enforce a lease containing a surrender clause—on the ground that it was a matter of relief in equity, and in a matter of that sort federal courts are not bound by state courts."

In the case of *Guffey* v. *Smith*, 237 U. S. 101, 59 L. ed. 856, Mr. Justice VAN DEVANTER, speaking for the Court, said:

> "The Supreme Court of Illinois, while fully sustaining the right to maintain such a suit in the courts of the state when the lease contains no clause giving the lessee an option to surrender it (*Gillespie* v. *Fulton Oil & Gas Co., supra*), holds that the presence of such a clause in the lease operates to prevent the lessee from directly or indirectly enforcing it in equity (*Watford Oil & Gas Co.* v. *Shipman*, 233 Ill. 9, 13, 14, 122 Am. St. Rep. 144, 84 N. E. 53, and *Lorey* v. *Keith*, 237 Ill. 284, 298, 86 N. E. 696), the ground of distinction being that the surrender clause, although lawful in itself, and not affecting the validity of the lease, renders it so lacking in mutuality that equity will remit the lessee to his remedy at law. These decisions, it is insisted, should have been accepted and applied by the Circuit Court. To this we cannot assent. By the legislation of Congress and repeated decisions of this court it has long been settled that the remedies afforded and modes of proceeding pursued in the federal courts, sitting as courts of equity, are not determined by local laws or rules of decision, but by general principles, rules and usages of equity having uniform operation in those courts wherever sitting. Rev. St., Secs. 913, 917; Comp. Stat. 1913, Secs. 1536, 1543; *Neves* v. *Scott*, 13 How. 268, 272, 14 L. ed. 140, 142; *Payne* v. *Hook*, 7 Wall. 425, 430, 19 L. ed. 260; *Dodge* v. *Tulleys*, 144 U. S. 451, 457, 36 L. ed. 501, 503, 12 Sup. Ct. Rep. 728; *Mississippi Mills* v. *Cohn*, 150 U. S. 202, 204, 37 L. ed. 1052, 1053, 14 Sup. Ct. Rep. 75. As was said in the first of these cases: 'Whenever a case in equity may arise and be determined, under the judicial power of the United States, the same principles of equity must be applied to it, and it is for the courts of the United States, and for this court in the last resort, to decide what those principles are, and to apply such of them to each particular case as they may find justly applicable'."

In the case of *City of Dallas* v. *Higginbotham-Bailey-Logan Co.*, 37 F. (2d) 513, the Circuit Court of Appeals for the Fifth Circuit held:

> "A federal court siting in equity is not bound by decisions of state courts."

If the Kansas decisions are in conflict by reason of *McCarney v. Freel, supra,* or are not clear and definite upon the precise question involved herein, the Circuit Court of Appeals was not required to follow said decisions.

That the Kansas decisions relied upon by the petitioners are not clear and definite upon the precise question involved herein is manifest from the conflict between the judges of the Circuit Court of Appeals herein with respect to their understanding of the applicability of said decisions, as well as that between opposing counsel herein. On the one hand, the majority of the Circuit Court of Appeals and counsel for respondent find nothing in said decisions which conflicts with the universal rule under consideration. On the other, Judge McDermott and counsel for petitioners seem to think otherwise. However, it is to be noted that Judge McDermott seems to entertain some doubt as to his interpretation of the Kansas decisions. He says, "if I am right in this analysis of the Kansas decisions," and, "if I am wrong in my construction of the earlier Kansas decisions." It, therefore, cannot be said that the Kansas decisions are clear and definite upon the precise question involved herein.

Likewise, the petitioners seem to be doubtful as to their construction of the Kansas decisions, for in their brief they

say, "if we do not construe correctly the Kansas decisions, the question was at least an open one."

The above proposition is fully sustained by the case of *Concordia Ins. Co. v. School Dist.*, 282 U. S. 545, 75 L. ed. 528, in which this Court said:

> "The general rule that a federal court will follow the decisions of the highest court of a state construing a state statute is, of course, well established. The difficulty here is that, prior to the judgment of the federal district court in this case allowing interest, the decisions of the Supreme Court of Oklahoma were in such confusion that the view of that court in respect to the meaning of the statute, as applied to the present case, could not definitely be determined."

Likewise, in *Edward Hines Yellow Pine Trustees v. Martin*, 268 U. S. 458, 69 L. ed. 1050, it was held:

> "When questions affected by the interpretation of a state statute or a local rule of property may arise in a federal court, that court has the same authority and duty to decide them as it has to decide any other questions which arises in a cause; *but where state decisions are in conflict, or do not clearly establish what the local law is,* the federal court may exercise an independent judgment and determine the law of the case."

In each of the decisions of this Court holding that the Federal Court was bound by the state court decisions that we have examined it appears that, unlike the case at bar, there was no controversy with respect to what the state court decisions held.

Criticism of Some of Petitioners' Comments on the Evidence.

The petitioners state that no producing well has been drilled closer to the premises involved than 400 feet, except the wells offsetting the two wells on said premises, when, as a matter of fact, no well, other than said offset wells, has been drilled closer than 660 feet. (Ex. 1, R. 67.)

The petitioners, in several places in their brief, state in effect that the respondent and its predecessors in title never drilled any "exploratory" well upon the premises involved, and that the two wells which they drilled had to be drilled by reason of the existence of offset wells on adjacent premises. If this were true, which it is not, it would be immaterial. Judge McDermott in his dissenting opinion herein commits the same error. Suffice it to say that well No. 2 on the premises involved was completed prior to the offset well on the adjacent premises and was, therefore, an exploratory well. (Ex. 1, R. 67.)

Both the petitioners and Judge McDermott state in effect that the respondent took the position that it would not drill an additional well or wells upon the premises involved unless some other operator drilled a well in the vicinity of the land involved which would demonstrate that it would pay to drill such additional well or wells. Under the authorities the respondent would be fully justified in taking such position, but as a matter of fact its position was not so limited. Respondent's vice-president, Mr. Moody, testified that respondent "had never abandoned any portion of the lease involved and had never intended to abandon any portion of it, and that if the future should prove it practical to drill another well on said lease the Mid-Continent Petroleum Corporation was capable and willing to drill it" (R.

51). He further testified that the lease involved was worthless from the standpoint of further development, "unless future development proved that defendant's theories were wrong"; that "by future development he meant that if there was any development in the vicinity that showed defendant's present theory of operation was wrong; that if some other company does any drilling in the vicinity which indicates that there might be oil on the land involved, the defendant would drill an additional well or wells on said land"; that respondent's geological records did not show that it was impossible for further development in the northwest corner of the lease involved, and "that if it was later developed that production could be obtained there defendant would be perfectly willing to develop further on the lease involved; that before there was any further development on the lease involved the defendant would have to gain further information; and that further information would be obtained by geology and drilling wells to the northwest" (R. 52). And we would also call attention to the following answes of Mr. Moody to questions propounded to him by the trial court:

> "By the Court: Somebody else would have to develop it?
>
> "A. We would have to gain further information than we have.
>
> "By the Court: How would you get that?
>
> "A. Geology.
>
> "By the Court: Your theory and your contention and the purpose of your company, is to hold this lease without any further development, or until somebody else develops something that might indicate to you—(interruption).
>
> "A. Or we gain further information ourselves." (R. 53)

The petitioners, repeatedly, and Judge McDermott, at least once, state that under the circumstances respondent "in all fairness" should give up the undeveloped portion of the lease involved and "let some one else drill it." We submit, however, that there is not a scintilla of evidence in the record to the effect that any reasonably prudent operator would drill a well upon said portion of said lease, much less that there was any one who had indicated to the petitioners, or any one else, that he was actually willing to drill such well. We might also reply that if there was some one who was actually willing to drill a well upon said premises, or even that a reasonably prudent operator would have drilled such well, it would have been quite simple for petitioners to have shown the same, and "in all fairness" they were required to do so. Furthermore, it is significant that there is no evidence that if the lease involved were cancelled petitioners would be able to procure another lessee.

The petitioners take issue with the testimony of respondent's vice-president, Mr. Moody, "that the average rate of earning produced by" the lease involved, "on the basis of expenditures, was approximately 5.1% per annum," which he said was a very small return for an oil venture. The aforesaid rate of earning is obviously arrived at by dividing the total profits of $26,229.21 by eleven, the number of years over which said profits accumulated, and then dividing the total expenditures of $46,464.97 into the annual profits, and of course was not intended to be technically correct. However, we submit that said rate of earning was more nearly correct than the 18.2% suggested by petitioners. Said figure of 18.2% was arrived at by petitioners without deducting the cost and expense of drilling and equipping the

two wells on the lease involved from the gross income, less only the estimated total costs of operation, and merely represents *the annual rate of return of respondent's expenditures* in drilling and equipping said two wells, and not *the rate of earning* on investment.

The confusion of petitioners, as well as Judge McDermott, is, in our opinion, due to the fact that the record discloses a very large number of wells drilled in the vicinity of the lands involved. This, however, is a mere circumstance which, in and of itself and without more, means nothing. It is a well known fact that there are fields in which a producing well can be drilled at almost any location and yet only a few of the wells drilled can be said to produce oil in paying quantities. Furthermore, the mere fact that a producing well has been drilled and is being operated is no indication that it is a paying well, for the operator may merely be taking such oil as he can get with the sole idea of minimizing his ultimate loss, but with no hope at all of making any profit on his total outlay. Consequently, the burden was upon the petitioners to establish that if an additional well were drilled upon the premises involved it not only would probably produce oil, but that it would probably produce it in such quantities as to yield a profit on the total cost of drilling, equipping and operating. And it may be suggested with respect to the large number of wells drilled in the vicinity of the lands involved herein that, while the initial production of some of said wells is shown, there is no evidence of the total amount of oil produced from any of them, nor is there any evidence that any of said wells, except several hereafter referred to, has ever repaid, or will ever repay, the total outlay in connection therewith. The

Court should, therefore, not be misled by reason of the large number of wells drilled in the vicinity of the lands involved.

Judge McDermott concedes and petitioners do not deny that the Bartlesville sand "pinched out" before it reached the premises involved, which conclusion is inescapable under the uncontradicted testimony, so that in the consideration of production on adjoining acreage we may wholly disregard wells producing from said sand (R. 97).

The petitioners and Judge McDermott state that the lime under the undeveloped portion of the lease involved was between 570 and 610 feet below sea level, and, referring to respondent's Exhibit E, state that on the section adjoining said lease on the southwest there were 23 producing wells where the lime was between 570 and 610 feet, and 9 higher than 570 feet, and 18 producing wells to the northeast within the 570 and 610 feet range, and 3 higher than 570 feet. From this they argue that the oil *could be produced* from the undeveloped portion of the lease involved. But conceding that oil *could be produced* therefrom, *no one says that the same could be produced in paying quantities* (B. 60, R. 97-98).

Moreover, an examination of the aforesaid Exhibit E discloses that all of the undeveloped portion of the lease involved lies between 580 and 610 feet below sea level, the greater portion being between 590 and 610 feet. Therefore, petitioners and Judge McDermott are in error when they state that the lime under said portion of said lease lies between 570 and 610 feet (R. 72a).

Further examination of said Exhibit E discloses that on the section to the southwest of the lease involved the deepest producing wells were 599 feet below sea level and

that 2 wells thereon, at 600 feet and 604 feet, respectively, were dry holes. And it is significant that no one contends any of said wells below 570 feet produced oil in paying quantities. With reference to the wells to the northeast of the lease involved, the deepest point at which the lime was encountered was 599 feet below sea level, and the lime in the majority of the said wells was above 580 feet (R. 72a).

The only evidence to the effect that any of the approximately 227 wells drilled on the lime on and in the vicinity of the lease involved ever produced oil in paying quantities was the testimony of Mr. Moody to the effect that the wells on the Northwest Quarter of Section 21, 3 of which were above 570 feet and had an initial production of 75, 60 and 65 barrels per day, respectively, had paid a small return on the investment, and that the two wells on the lease involved had produced oil in paying quantities (R. 48-49). It is absolutely impossible from the record to state that any other of said lime wells was a paying well. Furthermore, all of the witnesses who testified, knowing the results of the production in the Northwest Quarter of Section 21, the results of the production on the lease involved, and also probably knowing the results of the remaining lime wells, stated that they would not expect to find oil in paying quantities under any of the undeveloped portion of the lease involved. Mr. Brown, a wholly disinterested witness, testified that it would be necessary to find oil in lime wells in greater quantities than it had been discovered on the Northwest Quarter of Section 15, just east of the lease involved, to produce oil in paying quantities (R. 65). And an examination of the aforesaid Exhibit E and petitioners' Exhibit 1 discloses that one of the lime wells on said Northwest Quarter of Section

15 had an initial production of 35 barrels per day, and that the other two had an initial production of 5 and 10 barrels per day, respectively (R. 72a, 66a).

The respondent has never made the contention that no oil whatsoever could be produced from the undeveloped portion of the premises involved. Its position, which is supported by all the evidence, is that oil could not be produced therefrom *in paying quantities.* There is not a single circumstance in the entire record in the least inconsistent with the respondent's witnesses' testimony that in their opinion oil could not be produced in paying quantities from said premises. As before stated, the mere existence of a great number of producing wells in the oil field surrounding said premises, *in the absence of a clear showing that said wells produced oil in paying quantities,* is no evidence at all that oil could be produced from said premises in paying quantities, and this is especially true in the face of the testimony of the expert witnesses, with all of that development in mind, that they would not expect to find oil in paying quantities on said premises, and that a reasonably prudent operator would not drill a well thereon.

Respondent's Exhibit E further discloses that there were 24 wells drilled on lands surrounding those involved herein in which the lime was encountered at 600 feet and deeper below sea level, only 3 of which produced any oil. In other words, 88% of said wells were dry holes. Of the 31 wells between 590 and 599 feet below sea level, 41% thereof were dry holes. The initial production of 3 of the wells within that range was 25 barrels per day at 591 feet, 15 barrels per day at 594 feet, and 5 barrels per day at 599 feet (R. 72a). It is, therefore, obvious that an oil operator would

hardly invest $15,000.00 or $16,000.00 to drill a well, where the chances were over 50% that he would get a dry hole, with the largest producer he could hope for having an initial production of less than 25 barrels per day.

By considering respondent's Exhibit E with petitioners' Exhibit 1 we find that the average initial production of the lime wells on the Northwest Quarter of Section 21 was approximately 34 barrels per day, and that the average initial production of the two wells on the lease involved was 47.5 barrels per day. *These are the only two leases producing lime oil which the record discloses ever paid out, and they paid only a slight profit on the investment.* The closest lime producing wells to the northeast of the lease involved had an initial production of 10 and 15 barrels per day, respectively, and the largest producer, over 1/2 mile away, had an initial production of 25 barrels per day. Furthermore, there was a dry hole directly offsetting the lease involved to the west, and a dry hole 630 feet west of said lease and 290 feet north of the center line of Section 16, a dry hole to the north of said lease, a well on the Northeast Quarter of Section 21, south of said lease, which never paid out, and no evidence that any or all of the wells to the northeast of said lease ever paid out. So that every circumstance in the record absolutely corroborates the testimony of all of the experienced oil men who testified in the case at bar to the effect that oil could not be produced from the undeveloped portion of said lease in paying quantities (R. 72a, 66a).

The petitioners claim there is a trend of oil producing lime from the southwest corner of the lease involved to the northeast corner thereof, but respondent's Exhibit E dis-

closes that if there is any trend at all with respect to wells to the southwest of said lease said trend runs from the south almost straight north through the West Half of Section 16, and with respect to the wells to the northeast of the lease involved, if those wells are in any trend they are in a trend running from the southeast to the northwest, which entirely misses the northeast corner of the lease involved (R. 72a).

The petitioners assert that there was some probability of drainage from the lease involved and contend that the trial court's finding of fact with respect to drainage was sufficient to justify cancellation of said lease. The trial court, however, did not find that there was any drainage. It merely found that it was impossible to determine whether or not there was any drainage, without the drilling of test wells, and that there was a probability of drainage (R. 34-35). This was far short of a finding of a certain and substantial breach of the implied covenant to protect the premises involved from drainage. Furthermore, there is no evidence in the record that there was any drainage, and the testimony of all the witnesses is that there was none. Most certainly there were no lime wells to the west, to the south, to the north or to the east which could possibly have drained the premises involved. The only other wells are in the Southwest Quarter of Section 10, cornering said premises on the northeast, on which the closest lime well is over 1/4 mile away (R. 72a). But even though drainage were clearly established, under the authorities cited herein, there is no breach of the implied covenant to protect against drainage unless and until it is shown that the wells through which the drainage occurs produce oil in paying quantities

and are such wells as a reasonably prudent operator would offset.

Petitioners' Exhibit 1 shows that owners of leases adjoining the lease involved evidently have the same idea as respondent with respect to the practicability of further exploration. On the Southwest Quarter of Section 9, containing 160 acres, the Theta Oil Company has drilled only three wells, one a dry hole and the other two having an initial production of only 5 barrels. On the Southwest Quarter of said Section 9 no wells have been drilled. On the East Half of the Northwest Quarter of Section 16, containing 80 acres, the Syndicate Oil Company has drilled only one well, and that was dry. On the west half of said quarter section Parrish, *et al.*, have drilled only one well, with an initial production of only 5 barrels. On the Southeast Quarter of Section 8 no well has been drilled. On the Northeast Quarter of Section 17 the Skelly Oil Company has drilled no well. On the North Half of the Southwest Quarter of Section 16 the Florence Oil Company has drilled no well and said company has only drilled three wells on the Southwest Quarter of the Southwest Quarter of said section, one being a dry hole and the other two having an initial production of only 20 and 25 barrels, respectively. Only one well, with an initial production of 10 barrels, has been drilled on the Northwest Quarter of Section 21. And so on (R. 66a).

Conclusion.

The lease herein specifically provides that in the event the lessee discovers oil or gas in paying quantities, upon the leased premises, within ten years from the lease date, it shall continue in full force and effect, upon the whole of said premises—not any particular part thereof—as long thereafter as oil or gas, in paying quantities, is produced thereunder by the lessee. To limit the continuance of such a lease after discovery of oil or gas to any specific portion of the leased premises—whether the same be forty or a thousand acres—is to disregard plain and unequivocal language. No objection is made to the cancellation of such a lease where there has been a breach of either an express or an implied obligation of the lessee. Here it is not claimed that the respondent has violated any of its express obligations. The claim is that it has breached an implied obligation of its lease. And what is that implied obligation? Petitioners answer, the obligation to diligently and reasonably develop the leased premises. Well sounding words, but what do they mean? Certainly what is diligent and reasonable development does not depend solely upon lapse of time, or upon the amount of acreage covered by the particular lease, disregarding entirely the cost of the development, the prospects of discovering oil or gas, the cost of producing same, or the market therefor, to say nothing of other factors always considered by a reasonably prudent operator before deciding to commence a well. But that is exactly what the contention of petitioners reduces itself to,

and they would have the court believe that the Kansas decisions support them. Surely it cannot be said that the parties to an oil and gas lease ever contemplated that, notwithstanding the lessee had at great expense, discovered oil or gas in paying quantities and was producing same, he was required, in order to continue his lease as to the undeveloped portion of the leased premises, to keep drilling wells, in spite of the fact that there was no reasonable probability of discovering oil or gas therein, and in spite of the fact that no reasonably prudent operator would drill such wells. Instead of this being reasonable development it is the very opposite—unreasonable development. The implied obligation invoked by petitioners simply does not exist.

Respectfully submitted,

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